IN THE

Supreme Court of the United States

October Term, 1957.

No. 109.

TANK TRUCK RENTALS, INC.,
Petitioner,
v.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.

On Writ of Certiorari to the United States Court of Appeals for the Third Circuit.

Brief for the Petitioner.

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BRIEF FOR THE PETITIONER.

OPINIONS BELOW.

The opinion of the Tax Court of the United States (R. 115a-136a) is reported in 26 T. C. 427 (1956). The opinion of the United States Court of Appeals for the Third Circuit (R. 138-141) is reported in 242 F. 2d 14.

JURISDICTION.

The judgment of the United States Court of Appeals was entered on March 6, 1957 (R. 142). The petition for a writ of ceritorari was filed on April 22, 1957 and was granted on June 17, 1957 (R. 143). The jurisdiction of this Court rests on 28 U. S. C. Section 1254.

QUESTIONS PRESENTED.

I. Whether sums paid by petitioner, a bulk liquid motor carrier, pursuant to union contracts with its truck drivers to indemnify them against fines imposed on the drivers for operating on the Pennsylvania highways motor vehicles which exceeded the Pennsylvania weight law, were deductible as ordinary and necessary business expenses where:

a. Pennsylvania had lower weight limits than the surrounding states through which petitioner operated;

b. petitioner's standard size vehicles, when fully loaded with liquids other than gasoline, were necessarily always in excess of the Pennsylvania legal limit and subject to fines although they carried a weight permissible in the other states;

c. petitioner had to carry full loads to stay in business; and

d. the fines were required by Pennsylvania law to be used for road and highway maintenance and repair?

II. Were similar fines imposed by the states of New Jersey, Maryland, Ohio, West Virginia, and Delaware directly on the carrier so deductible where:

a. New Jersey, although having a weight limitation considerably higher than that of Pennsylvania, had a reciprocity provision whereby a vehicle registered in Pennsylvania had to comply with the stricter Pennsylvania limit, causing petitioner's Pennsylvania registered vehicles operating in New Jersey to be subject to New Jersey fines when their weight exceeded the lower Pennsylvania limit, even though the weight was under the limit otherwise permissible by New Jersey law; and

b. the weight laws of the other states were sufficient to assure maximum utilization of the standard size equipment and any operation of overloaded vehicles subject to fine was innocent, inadvertent and without petitioner's knowledge at the time of the trip?

STATUTES AND REGULATIONS INVOLVED.

Internal Revenue Code of 1939:

Sec. 23. Deductions from Gross Income.

In computing net income there shall be allowed as deductions:

(a) [as amended by Sec. 121 (a), Revenue Act of 1942, c. 619, 56 Stat. 798, 819]. Expenses.—

(1) Trade or business expenses.—

(A) In general.—All the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, * * *

* * *

(26 U. S. C. 1952 ed., Sec. 23 (a).)

Treasury Regulations 111, promulgated under the Internal Revenue Code:

Sec. 29.21-1. Meaning of Net Income.—* * * The normal taxes and surtaxes imposed on individuals and on corporations are computed upon net income less certain credits. Although taxable net income is a statutory conception, it follows, subject to certain modifications as to exemptions and as to deductions for partial losses in some cases, the lines of commercial usage. Subject to these modifications statutory net income is commercial net income * * *

Sec. 29.23(a)-1. Business Expenses.—Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business, except the classes of items which are deductible under sections 23(b) to 23(z), inclusive, and the regulations thereunder. * * *

The pertinent provisions of Sections 719, 903, 904, 905, and 1207 of the Vehicle Code of Pennsylvania, Act of May 1, 1929, P. L. 905, as amended, and of Act No. 70, approved and effective June 30, 1955, amending, inter alia, Sections 903 and 904 of the Vehicle Code of Pennsylvania, are set forth in the Appendix, *infra*.

STATEMENT.

This case involves the income tax liability of Tank Truck Rentals, Inc. for the calendar year 1951. The facts found by the Tax Court material to the questions presented are substantially as follows (R. 115a-130a).

General History.

Petitioner was part of the industry engaged in the business of transporting bulk liquids by motor vehicles. Petitioner had no operating certificates of its own issued by the Interstate Commerce Commission or the State Public Utility Commissions, but, as a lessor, leased its motor vehicles and furnished the driver as its own employee to motor carriers holding such certificates, who also owned and operated large fleets of their own (R. 115a).

Petitioner and its industry witnesses, hereinafter sometimes referred to as the industry, represented carriers who transported a substantial portion of the bulk liquids carried over-the-road by all motor carriers in the states of Pennsylvania, New Jersey, Ohio, Maryland, Delaware and West Virginia during the taxable year. Over-the-road means transportation between towns and cities, but not solely within a municipality. Petitioner and the industry operated inter- and intra-state (R. 115a-116a).

Each of the states involved prescribed a maximum weight for motor vehicles using its public highways. Pennsylvania had lower weight limits than the other states. The Pennsylvania limit in 1951 was 45,000 pounds, plus a 5% leeway, or a total of 47,250 pounds. This limit had remained unchanged from as far back as 1943 until it was increased by legislation in 1955. The other states, by 1951, prescribed generally a maximum weight of 60,000 pounds (R. 117a-118a).

Substantially the same equipment was used and operated in the industry generally throughout the states. It consisted of truck tractor and semi-trailer combinations.

The bulk of the industry's semi-trailer fleets contained tanks with a capacity ranging from 4,500 to 5,000 gallons. Petitioner was formed in 1945 and during World War II only single compartment tanks within the 4,500 to 5,000 gallon range were available for purchase. This was due to restrictions relating to the conservation of steel, and the attempt to have a uniform standardized size of tank for maximum utility which would comply generally with the weight restrictions in most of the states in the United States (R. 116a-117a, 123a).

The weights of the bulk liquids commonly carried varied from 6 pounds per gallon for gasoline to 8 pounds per gallon for Bunker "C" oil. The equipment was standardized in weight ranging between 20,000 pounds and 22,000 pounds, unloaded. Thus this equipment, when fully loaded with any liquid other than gasoline, was always in excess of the legal limit in Pennsylvania, but generally within the maximum prescribed by the other states whose weight limits assured capacity use of the standard equipment (R. 117a, 120a, 124a, 131a).

It was the common, widespread and long established practice in the industry in Pennsylvania and in the other states to fill the semi-trailer tanks to capacity (118a). Only by operating maximum loads were petitioner and the other carriers able to remain in business. The rate structure in the industry was predicated upon the carriage of 4,500 gallons (47,000 to 58,000 pounds) per trip and petitioner's rental for its equipment and driver was based on a percentage of the tariff received from the customer by its lessee-certificated carriers in the industry. Discontinuance of the practice of filling to capacity would have reduced petitioner's operating revenue per gallon hauled, while operating costs would have increased because of the additional number of trips required, thus causing petitioner to operate at a loss and go out of business. An increase in petitioner's rentals, to compensate for the reduced pay load

per trip would have referred the business to the other carriers. Petitioner chose to remain in business and conform to the industry's practice of overloading (R. 37a-38a, 124a-125a).

Aside from the revenue factor, it was not feasible for petitioner or the industry to load the tanks partially in order to conform to the Pennsylvania weight requirements. This would have created a hazard to the safety of operation for the reason that the surge created in the partially filled tank causes difficulty in stopping the motor vehicle and in negotiating curves along the highways (R. 125a).

Acquisition of smaller equipment, although it would have avoided the hazard to public safety of the partially filled tank, would have been just as uneconomical as carrying partial loads. Moreover, in determining industry policy with respect to the size of equipment to be used in Pennsylvania, one of the factors which necessarily had to be considered was the legislation which was proposed from the time of petitioner's formation in 1945 in each successive session of the Pennsylvania Legislature to increase the weight requirement to conform to that of the neighboring states, which if enacted as it finally was in 1955, would have rendered the fleet of smaller equipment entirely obsolete (R. 11a, 41a, 125a-126a, 130a, 75 Pa. Purdon Stat. § 453 (pocket part)).

In addition, although approximately 100% of Petitioner's operations had some contact with the state of Pennsylvania—the transportation taking place either wholly within Pennsylvania or Pennsylvania being the destination or originating state on interstate shipments—nevertheless petitioner was engaged in a substantial amount of interstate business, as were all the other carriers in the industry. It was essential that the equipment owned and operated by petitioner and the other carriers be suitable economically in the neighboring states where they operated which allowed the larger standardized equipment to

be fully utilized. Semi-trailer tanks with a capacity small enough to be fully utilized for purposes of the Pennsylvania weight requirements were virtually worthless to petitioner and the other carriers in their operations in any state other than Pennsylvania (R. 126a).

Furthermore, in Pennsylvania an increase in rates by the industry as a whole to compensate for the loss in revenue per trip for the operation of the smaller equipment would have referred the business to the railroads and to the motor vehicle fleet privately owned and operated by the refineries, the main customers of the over-the-road bulk liquid carriers. In the neighboring states such an increase would have referred the business to competing carriers avoiding Pennsylvania in their operations. Accordingly, petitioner and the other carriers decided to utilize fully their standard equipment in Pennsylvania as well as in the other states, rather than abdicate the business (R. 125a-126a).

Although the Pennsylvania statute contained a provision for granting a one-trip particular load permit to exceed the legal limit for each overweight vehicle, upon payment of a fee, this procedure did not offer a practical solution to the dilemma in which petitioner and the other carriers found themselves. The fees were not insubstantial and the procedure was cumbersome, with resultant delay to both the shipper and the consignee. This was especially true on interstate operation, when a vehicle was overweight in Pennsylvania as a result of a continuous trip. Moreover, it was doubtful if the permit would have been granted, since it was the policy of the Pennsylvania authorities not to issue the permit where the overweight could be avoided by not filling the tank to capacity. Hence, it was the industry practice, followed by petitioner, not to seek the permit and instead to take the risk of incurring a fine (R. 43a-44a, 126a, 131a, 75 Pa. Purdon Stat. § 455).

As a consequence of the uniform practice to fill the tanks to capacity and operate equipment exceeding the

maximum gross weight allowed by Pennsylvania law, the vehicles of petitioner and the other bulk liquid carriers were frequently stopped by the police in 1951 and fined the statutory amount, plus incidental costs, of $25.00 for a vehicle not exceeding 10% of the maximum weight, and $50.00 for a violation over 10%. Petitioner's vehicles were stopped and fined 711 times. The fines imposed amounted to $36,836.15, including costs. Petitioner's vehicles and those of the other carriers were overweight in Pennsylvania a substantial number of times in excess of the number of times they were stopped and fined (R. 119a-120a, 126a-127a).

Pennsylvania Public Policy.

By Pennsylvania law, the fines were imposed on the employee-driver of the overweight vehicles, and not, as was the case with the other states, on the carrier-owner. Under union negotiated contracts with its employee-drivers, petitioner was obligated to indemnify the drivers and consequently, did pay the fines for the overweight vehicles. The other carriers did likewise (R. 14a-16a, 128a).

Under the Pennsylvania statute the fines for operating overloaded vehicles within local municipalities were required to be paid to and used by such local municipality for the construction, repair and maintenance of its highways (R. 132a, 75 Pa. Purdon Stat. § 737).

Imprisonment of the driver of a Pennsylvania overweight vehicle was provided for only upon default in payment of the fine. None of the petitioner's drivers was ever imprisoned, had his license suspended or was subjected by the Pennsylvania authorities charged with enforcing the overweight provision to any sanction other than the fine, and this was true for the employee-drivers of the other carriers (R. 128a, 75 Pa. Purdon Stat. § 453).

During the years of World War II and up to the latter part of 1950, petitioner's overweight vehicles were not

stopped and fined by the Pennsylvania enforcement authorities (R. 129a).

The Pennsylvania statute provided for removal of the excess load in the discretion of the enforcement authorities before the overweight vehicle could continue enroute, but neither the petitioner nor the other carriers was ever required to remove any excess load before its overweight vehicle was permitted to continue on the Pennsylvania highways. In some instances the other states did enforce a similar type removal provision (R. 44a-45a, 82a, 129a, 75 Pa. Purdon Stat. § 454).

No sanctions were imposed by Pennsylvania on the petitioner or the other carriers in 1951 for operating the overloaded equipment, other than by way of the fines imposed on the employee-drivers (R. 129a).

It was the practice of motor carriers subject to the jurisdiction of either the Interstate Commerce Commission or the Pennsylvania Public Utility Commission to include in their books, records and reports, fines for overloaded motor vehicles in an operating expense account sub-titled "Fines for Traffic Violations", and not in a non-operating expense account covering "Penalties and Fines for Violations of Law, except Fines for Traffic Violations". These accounts were prescribed by the Uniform System of Accounts promulgated by the I. C. C. and adopted by the Penna. P. U. C. Operating expense items are considered, and non-operating expense items are not considered, for rate making purposes. The Interstate Commerce Commission periodically examines and reviews the books, records and reports of motor carriers subject to its jurisdiction and no change or adjustment was made by it for the year 1951 or for the years prior thereto with respect to the reporting of such fines for weight violations as an operating expense (R. 129a-130a).

Petitioner was organized on January 1, 1945. From 1942 to the latter part of 1950, it was the policy of the

Commissioner of Internal Revenue, by letter ruling dated September 10, 1942, to allow fines incurred by motor carriers for violation of the laws relating to maximum weight to be deducted as ordinary and necessary business expenses on the ground they more nearly resembled tolls, allowing the carriers the right to proceed upon the state highways without interference, than as penalties imposed as a punishment for violation of law. By special ruling dated November 30, 1950, the Commissioner reconsidered the matter and concluded that the fines were no longer deductible (Appendix, 9a-12a).

The Tax Court concluded that although the Pennsylvania violations were widespread and common, and petitioner would have been at a competitive disadvantage in the operation of its business unless it did engage in such practices, nevertheless the Pennsylvania violations were conscious and deliberate, represented a calculated risk taken by petitioner and the other carriers, and the fines paid were criminal penalties for violation of state law. Accordingly, the Tax Court disallowed the Pennsylvania fines as deductible ordinary and necessary business expenses, since the deduction would, in the opinion of the Tax Court, have the effect of mitigating the degree of punishment and of frustrating the purpose and effectiveness of the Pennsylvania weight limit (R. 131a-133a). The Court of Appeals affirmed this holding by reasoning that the weight legislation in and of itself created a sharply defined state policy which in a tax controversy could not thereafter be examined (R. 140).

New Jersey.

Petitioner incurred and paid to New Jersey fines and incidental costs on seven different occasions aggregating $2,830.00 for operating overloaded vehicles on the New Jersey highways. The New Jersey limit was 60,000 pounds. In all cases known to petitioner, at no time did petitioner operate vehicles in the state of New Jersey carrying a

weight in excess of the 60,000 pounds prescribed generally for the equipment in that state and this was true for the other carriers in the industry. However, the seven fines were levied under a reciprocity provision of the New Jersey law whereby motor vehicles licensed and registered in Pennsylvania, although carrying a weight less than the 60,000 pounds allowed generally, were in violation of the New Jersey weight limitation law if their weight was in excess of the 45,000 pounds, plus the 5% leeway, allowed by Pennsylvania (R. 119a, 133a).

The interstate operation of the bulk liquid motor vehicles was a common and frequent occurrence in the industry and the widespread practice of filling the tanks to capacity, although not creating a weight in excess of the 60,000 pounds allowed generally by New Jersey law, nevertheless caused petitioner's and the industry vehicles to exceed the Pennsylvania limit on a substantial number of the New Jersey trips (R. 116a, 126a, 127a).

The Tax Court concluded that New Jersey, for reasons best known to itself, had undertaken to accommodate its penal provisions to those of Pennsylvania by the reciprocity provision, and made it a criminal offense to operate Pennsylvania vehicles on the New Jersey highways which exceeded the lower Pennsylvania limits. It reasoned that the violations were just as deliberate as the ones occurring in Pennsylvania itself, and the fines and costs were similarly not deductible (R. 133a). This likewise was the conclusion of the Court of Appeals (R. 141).

Other States.

Petitioner incurred and paid in 1951 twenty-eight fines, including incidental costs, aggregating $1,294.69 in the states of Ohio, Delaware, Maryland and West Virginia. The fines pertained to overweight violations which were neither wilful nor negligent, and this was true of the industry as a whole. By the very nature of the commodity and the equipment, the exact weight could not be always

controlled. Temperature changes could produce a variance in weight, residual variations in the same commodity of different refineries produced variances in weight, and a combination of a particular tractor with a particular semi-trailer could, at times, produce an axle weight violation, all of which took place despite any precautions that could fairly be demanded consistent with a practical operation of the business (R. 119a, 122a, 123a, 127a).

With respect to the violations in these states, the Tax Court adopted the reasoning of the District Court in *Hoover Motor Express Co., Inc. v. U. S.*, 135 F. Supp. 818, and held that even assuming that petitioner took every precaution that could fairly be demanded of a prudent motor carrier consistent with a practical operation of its business to comply with the weight limitations, nevertheless the weight laws treated the wilful and innocent violator alike, and to allow the income tax deduction for inadvertent and innocent violations would frustrate clearly defined policies of the applicable state weight statutes (R. 134a-135a). Similarly, the Court of Appeals found no justification for distinguishing between the wilful breach and the innocent mistake, and concluded that the purpose of the motor vehicle laws would be frustrated just as much in the unintentional cases as in the wilful transgressions, since they were in disregard of the local laws (R. 141).

SUMMARY OF ARGUMENT.

I.

The sums paid by reason of the state fines imposed for operating motor vehicles which exceeded the maximum gross weight prescribed by the statutes of Pennsylvania, New Jersey, and the other states were deductible as ordinary and necessary business expenses under Section 23(a)(1)(A). The long established and widespread practice in the industry was to fill the standard sized equipment to capacity, causing it to exceed the extremely low maximum weight required by Pennsylvania law, although it conformed to the weight allowed by all the other states through which petitioner and the industry operated interstate. Only by such capacity loading was petitioner able to remain in business and the operation of such vehicles, from which the Pennsylvania fines arose, was of common and frequent occurrence in the industry.

The New Jersey fines pertained to interstate operations where petitioner's Pennsylvania vehicles, although they carried a weight otherwise permissible under New Jersey law, were in excess of the considerably lower limit permitted by Pennsylvania and were therefore in violation of a reciprocity provision of the New Jersey statute. The payment of the fines in the neighboring states arose from interstate operations where the violations were neither wilful nor negligent and occurred despite every precaution that could fairly be demanded, consistent with a practical operation of the business. Hence, the fines arising out of all of the violations were common, frequent, appropriate, and necessary in the type of business involved. In short, they were deductible as ordinary and necessary business expenses.

The disallowance of the deductions sought was predicated upon a clearly erroneous "public policy" qualification of the generally accepted meaning of the words "ordinary and necessary"—that to give income tax recog-

nition to the fines as deductible business expenses would frustrate a sharply defined state policy evidenced by the respective weight limitation laws.

The legislative history of the income tax law amply demonstrates that Congress specifically has considered on more than one occasion and has rejected any qualification that would deny deductibility to ordinary and necessary business expenses on a public policy rationale applicable to expenditures which themselves violated a state law or were incidental to such violation. The applicable Treasury regulations and opinions of this Court reaffirm this legislative history that the revenue act is concerned with the taxation of net income, unaffected by any restriction of public policy and is not designed as an arm of the law to enforce state criminal statutes by augmenting the punishment which the state inflicts. Since Congress has not done so, it is not at all relevant to consider whether Congress, had it chosen, might have excluded expenses incurred directly in violation of state law or fines incidental thereto from permissible deductions.

There is no warrant in the opinions of this Court in *Commissioner v. Heininger*, 320 U. S. 467 (1943), and *Lilly v. Commissioner*, 343 U. S. 90 (1952) for the assertion that this Court has approved any "judicial gloss" of public policy. On the contrary, the opinions indicate that any test based on illegality or public policy must be abandoned as a judicial guide. Instead of any workable rule or legal theory which is of rational use, there has evolved in the lower courts only confusion and chaos in attempting to apply an illegality or public policy test for the disallowance of deductions, in the absence of definitive legislative standards. If frustration of national or state policies evidenced by governmental statutes is the proper touchstone of non-deductibility, there can be no relevant distinction between fines and penalties imposed and the legal expenses incurred in an unsuccessful defense to prevent their collection. Yet the lower courts attempt to make the distinction. The legal expenses have been held deductible, the fines apparently not.

Furthermore, violations of complicated and involved statutes and regulations are today a common business risk, and penalties incurred in the ordinary course of business a normal cost of doing business. A rule developed by the lower courts refusing to allow the deduction of fines or penalties if the violations were deliberate or avoidable, but allowing them in some instances if they were unintentional and avoidable, is not justified by the numerous decisions which have repeatedly held that a taxpayer may deduct damages paid to a private person because of a wrong or tort committed in the operation of his business, regardless of his wilfulness or deliberateness. Nor can the private and public wrong situations be distinguished properly on the ground that one involves restitution as opposed to penalty, or that a private party plaintiff is involved as opposed to the sovereign.

This Court's opinion in *Textile Mills Securities Corp. v. Commissioner*, 314 U. S. 326 (1941) gives no support to any application of the public policy doctrine by the lower courts, in view of the contrary congressional policy expressed and the absence of any interpretive regulation applicable to fines and penalties imposed by state law.

Moreover, if there can be deducted, as has been held, the integral unlawful expenses of an illegal business, morally wrong and socially condemned, the transgressions of a socially desirable, legitimate business here presented cannot properly be singled out for tax punishment by the disallowance of expenses, otherwise ordinary and necessary, which may be incidental thereto.

The existence of taxable income where there is none cannot be permitted to be found merely on the ground of some public policy. This has been partly recognized in the fictitious differentiation which is said to require that illegal payments entering into the cost of goods sold or serving as a reduction of gross receipts must be taken into account in the computation of gross income, whereas similar illegal payments are not deductible as ordinary and

necessary business expenses. Such an artificial distinction should be wiped out and the only consistent and realistic approach is to disregard illegality, immorality, and public policy as such and determine tax liability on the basis of the taxpayer's true commercial net income, however, it is produced. Abandonment of a public policy test, which uses the deduction provision as a medium for judicial expression of moral attitudes, would not mean that all sorts of illegal and immoral expenses would automatically become deductible. The proper statutory criteria of "ordinary and necessary," as interpreted by this Court, would still allow most of the objectionable payments to be disallowed where they are either not ordinary or necessary in the particular business involved. This means that the fines involved herein, arising from customary, normal overweight operations necessary to petitioner's continued business life, meet the statutory standard.

This proper approach gives no advantage to the illegitimate over the lawful enterprise since each type of business is to be separately examined to see whether or not the expenses sought to be deducted are in fact ordinary and necessary for that business.

The tax laws are to be interpreted so as to have a uniform application in the states of the United States. State laws vary far too much in their scope and operation to allow the purpose of taxing net income to be dependent on state whim or to justify federal interference into fields of law enforcement heretofore wholly left to the states and local communities.

The public policy test of the lower courts places socially harmless individual violations of unpopular or anachronistic legislation, having no purpose to suppress crime, but merely the objective of prohibiting acts contrary to local notions of public policy, on a par with organized criminal activity. Unless checked, this test leads to a tax on gross, not on net income, contrary to the intendment of the revenue

act, by outlawing purely legitimate expenses incurred in any activity which a state may be said to seek to prevent.

II.

Even if certain expenditures otherwise ordinary and necessary under Section 23(a)(1)(A) are not deductible if they are penalties, the allowance of which would frustrate a sharply defined national or state policy, the payments which were made in connection with the three types of fines presented here are still deductible. The tax sanction of nondeductibility, when predicated upon such frustration, can still only be justified if the tax deduction would interfere with enforcement provisions, designed to punish past and deter future violations, of state statutes containing a "sharply defined," i.e., important and rational state policy that warrants the type of social condemnation that is or ought to be implicit in the concept of crime.

The fine in the Pennsylvania scheme of enforcement was neither, in fact or intention, punishment for past nor a deterrent to future overweight violations. Instead, it was imposed as a remedial or revenue measure, to cover restitution for supposed damage to the highways of the state. The legislature recognized this by consciously imposing the fine in one of two fixed non-graduated amounts, not on the carrier actually responsible for the violation, but on the employee-driver, and providing expressly that the fines be used by the local municipalities for the construction, repair, and maintenance of its highways. The studied enforcement policy, always to accept the small fine and never to require removal of excess load, likewise demonstrates an intention to allow uninterrupted, continued operation of the overloaded equipment. In addition, the 1955 amendments to the Vehicle Code of Pennsylvania indicate a legislative recognition of the place of the fine in the earlier scheme of enforcement—to allow continued operation of equipment which had been operating in adjoining states

without causing damage to the roads or an obstacle to traffic upon payment of a fee in the form of a fine.

This also was the exact position previously taken by the respondent himself, when by letter ruling in effect during the period 1942-1950, the payments of fines for overweight violations were held deductible as ordinary and necessary business expenses in the nature of tolls, rather than as penalties. In addition, the fact that neither the Pennsylvania Public Utility Commission nor the Interstate Commerce Commission for its own purposes outlawed the fine as a legitimate operating expense of motor carriers, indicates that the allowance of the fines as income tax deductions would not be offensive to the real policies and purposes of the Pennsylvania weight limitation law. Thus, since Pennsylvania was content freely to permit continued operation of the overloaded equipment upon payment of the small fine, an integral part of the cost of such continued operation, even in the form of a fine, is a tax deductible business expense.

The tax deduction of the fines imposed by New Jersey for operating on the New Jersey highways vehicles bearing a weight in excess of the Pennsylvania limit, but otherwise permissible under New Jersey law, would not frustrate any sharply defined policy of either New Jersey or Pennsylvania law to protect persons or property on the highways of the respective states.

The allowance of the tax deduction for the payments of the fines imposed for the inadvertent and unintentional violations in the other states would in no way frustrate the deterring or punishing aspects of the state statutes. The fines were incurred despite every precaution that could fairly be demanded, consistent with a practical operation of the business, and although the weight laws make no express distinction between innocent and wilful violators, justification for this can be found in an attempt to eliminate delaying litigation before the minor judiciary, rather than to punish each equally.

ARGUMENT

I. The Amounts Paid by Reason of the State Fines Imposed for the Overweight Violations Are Deductible as Ordinary and Necessary Business Expenses.

Petitioner, a motor carrier of bulk liquids, paid obligations in the taxable year 1951 for three types of fines, all for operating on the highways of the various states motor vehicles which exceeded a statutory weight limitation. A substantial majority of the violations occurred in Pennsylvania. Pennsylvania had considerably lower weight limitations than the surrounding states through which petitioner and the industry operated. It was the common, widespread and long established practice in the industry to fill the vehicles to capacity. Petitioner had to carry full loads in order to stay in business, although when its standard size vehicles were so loaded with liquids other than gasoline, they were necessarily always in excess of the Pennsylvania legal limit and subject to fines, despite the fact they carried a weight permissible in the other states. Sums accordingly were paid by petitioner, as was true with the industry as a whole, pursuant to union contracts with its truck drivers to indemnify them against the fines imposed by Pennsylvania on the drivers for so driving the overloaded equipment.

In addition, fines were imposed on petitioner directly—in some instances by New Jersey, which used the lower Pennsylvania weight limitation for petitioner's Pennsylvania licensed vehicles, despite the fact the vehicles were within the weight prescribed generally by New Jersey law, and in the other instances, by the remaining states involved, where the violations admittedly were innocent, inadvertent and occurred despite every precaution that could fairly be demanded, consistent with a practical operation of the business.

The respondent, Tax Court and Court of Appeals, disallowed the deduction sought by petitioner for these payments as ordinary and necessary business expenses under Section 23(a)(1)A, on the asserted ground of public policy. It is the petitioner's main contention that there is no warrant in the Internal Revenue Code, the applicable Treasury regulations or the decisions of this Court for the "judicial gloss" of public policy and that the fines sought to be deducted were plainly allowable as ordinary and necessary business expenses. Moreover, even if certain expenses otherwise ordinary and necessary under Section 23(a)(1)A are not deductible if their allowance would frustrate sharply defined national or state policies, it is petitioner's alternative contention that no such frustration is presented in any of the three types of fines involved herein.

a. *Legislative History.*

This Court has pointed out that "There is no statement in the Act or in its accompanying regulations, prohibiting the deduction of ordinary and necessary business expenses on the ground that they violate or frustrate 'public policy'." *Lilly v. Commissioner*, 343 U. S. 90, 94 (1952). The legislative history of the income tax law amply demonstrates that the Congress specifically has considered on more than one occasion and has rejected any qualification that would deny deductibility to ordinary and necessary business expenses on a public policy rationale applicable to expenditures which themselves violated a federal or state law or were incidental to such violation. The 1913 bill, as reported by the Senate Finance Committee, in Section II(A) and (G) (b) (38 Stat. 116) (the predecessor to Section 23(a) (1)A) granted individuals a deduction for the "necessary expenses actually paid in carrying on any business," gave corporations a similar deduction for "all the ordinary and necessary expenses paid within the year in the maintenance and operation" of their "business and

properties" and in the same section authorized individuals to deduct "losses actually sustained during the year, incurred in trade" and corporations "all losses actually sustained within the year." Seidman, Legislative History of Federal Income Tax Laws, 1938-1861, pp. 992, 995 (1938). Senator Sterling of South Dakota proposed several amendments contending that these provisions were too generous, that they should be "qualified by some such expression as 'losses incurred in legitimate and ordinary trade pursued by the party' or equivalent words." 50 Cong. Rec. 3849 (1913). "It is the purpose of the amendment simply to prevent a claim for losses or a deduction of losses arising out of a trade or business carried on in violation of law." 50 Cong. Rec. 4613 (1913).

The suggested amendments were rejected. Senator Williams, who opposed the proposal, stated in debate, ". . . the object of this bill is to tax a man's net income; that is to say, what he has at the end of the year after deducting from his receipts his expenditures or losses. It is not to reform men's moral characters; that is not the object of the bill at all. The tax is not levied for the purpose of restraining people from betting on horse races or upon 'futures,' but the tax is framed for the purpose of making a man pay upon his net income, his actual profit during the year. The law does not care where he got it from, so far as the tax is concerned, although the law may very properly care in another way." 50 Cong. Rec. 3849 (1913).

Although Senator Sterling's proposals were directed in part to deductible losses rather than deductible expenses, the debates clearly indicate Congress had no intention of limiting either deduction, whether technically "losses" or "expenses," in the manner proposed. Nor have the respondent or the courts differentiated between expenses and losses in applying the disallowance doctrine of public policy. *U. S. v. Algemene Kunstzijde Unie N.*

U., 226 F. 2d 115 (C. A. 4, 1955), certiorari denied, 350 U. S. 969 (Loss incurred by foreign corporation doing business in this country when certain of its assets were vested by the United States under the Trading with the Enemy Act); *Fuller v. Commissioner*, 213 F. 2d 102 (C. A. 10, 1954) (Loss incurred when whiskey, being sold in a dry state, was confiscated by law enforcement officials).

In 1951 Senator Kefauver four times sought unsuccessfully to amend Section 23(a)(1)A by prohibiting deductions "for any expense incurred in or as a result of illegal wagering." 97 Cong. Rec. 12230-31 (1951). He preferred this type of amendment to the proposed wagering tax. Senator George argued that, since the income tax is a tax on the net, if a taxpayer's losses exceed his gains, there is nothing to tax. He found, therefore, that Senator Kefauver's proposal by way of substitute for the wagering tax was "clearly an illegal, unconstitutional proposal to deny deductions against the income of someone who has been engaged in a wagering enterprise." 97 Cong. Rec. 12244 (1951).

Furthermore, prior to the recodification of the Internal Revenue Code in 1954, the American Law Institute recommended that Congres change the statute to disallow deductibility "for any expenditure which is—

> (1) itself illegal or contrary to a governmentally declared national or state policy proscribing a particular type of conduct; or
>
> (2) applicable to an obligation in the nature of a fine or penalty imposed by law, and not primarily for compensatory damages nor incurred despite the taxpayer's exercise of appropriate care, if the deduction of the expenditure for tax purposes would clearly frustrate a policy of the legislation imposing the obligation." (Section X165(i), American Law Institute, Federal Income Tax Statute (February 1954 draft, Vol. I)). However, Section 23(a)(1)A as re-enacted in Section 162 of the 1954 Code remained unchanged in this respect.

This legislative history, revealing that the Congress deliberately has refused to qualify ordinary and necessary business expense deductions by reference to illegality or public policy, is not impaired by the failure of the Congress to take affirmative action from the time the public policy doctrine began to evolve in the lower courts. The first appellate decision recognizing the penalty and attorney fee aspects of the doctrine did not appear until the 1930 decision in *Great Northern Ry. Co. v. Commissioner*, 40 F. 2d 372 (C. A. 8), certiorari denied, 282 U. S. 855 (Fines for violations by railroad of federal regulatory statutes and attorney fees for unsuccessful defense thereof). Since then the doctrine has had, as will be shown, a most confusing career in the courts. This Court has on occasion commented on the lack of significance of congressional silence. "Re-enactment—particularly without the slightest affirmative indication that Congress ever had the *Highland Farms* decision before it—is an unreliable indicium at best." *Commissioner v. Glenshaw Glass Co.*, 348 U. S. 426, 431 (1955)). ". . . we walk on quicksand when we try to find in the absence of corrective legislation a controlling legal principle." *Helvering v. Hallock*, 309 U. S. 106, 121 (1940).

Moreover, for a period of almost eight years, from September 1942 to December 1950, the respondent himself ruled that the exact types of fines involved in the instant case covering violations by motor carriers of state laws relating to maximum weights of the type of trucks involved herein were deductible as ordinary and necessary business expenses (Appendix, 9a-12a). And during this period of congressional silence, a good deal of the public policy doctrine, as urged by respondent, was rejected by this Court in *Commissioner v. Heininger*, 320 U. S. 467 (1943) (Attorney fees deductible for unsuccessful defense against a postal fraud order) and by the Second Circuit in *Jerry Rossman Corp. v. Commissioner*, 175 F. 2d 711 (1949) (Penalty for innocent O. P. A. price violation deductible).

In addition, there is ample evidence that the Congress will affirmatively speak out on public policy grounds when indeed it wants to. Scattered throughout the Code are various indications of congressional awareness of policy considerations involved. For example, Section 23(h), which was first enacted in 1934 (Section 23(g) of Revenue Act of 1934, 48 Stat. 680) limits the deduction of losses from all gambling, legal or illegal, to wagering gains, as a means, not of penalizing gambling, but of preventing a specific type of tax evasion whereby gambling losses were previously deducted and taxable gambling gains unreported. And Sections 23(o)(2) and 23(q)(2) permit a limited deduction for charitable contributions only if no substantial part of the activities of such charities is the carrying on of propaganda or otherwise attempting to influence legislation. Even more significant is the fact that where Congress has wished to deny tax deductions as a means of reinforcing the sanction of other federal statutes, it has explicitly so provided. Violations of the wage stabilization provisions of the Stabilization Act of 1942 (Sec. 5(a), 56 Stat. 767 (1942), 50 U. S. C. A. App. 965(a)) and of the Defense Production Act of 1950 (Sec. 405(b), 64 Stat. 807 (1950), 50 U. S. C. A. App. Sec. 2105(b)) and of the price ceiling provisions of the Defense Production Act (Sec. 104(i), 65 Stat. 136 (1951), 50 U. S. C. A. App. Sec. 2105(a)) can statuterily lead to a certification to the Treasury Department for income tax disallowance of wages and the purchase price of goods. See *Pedone v. U. S.*, 151 F. Supp. 288 (Ct. Claims, 1957), certiorari applied for; *Commissioner v. Weisman*, 197 F. 2d 221 (C. A. 1, 1952).

b. *Tax on Commercial Net Income.*

The applicable Treasury regulations and opinions of this Court reaffirm the foregoing legislative history that the Income Tax Act is concerned with the taxation of the "commercial net income" unaffected by any restriction of

public policy. "Although taxable net income is a statutory conception, it follows, subject to certain modifications as to exemptions and as to deductions for partial losses in some cases, the lines of commercial usage. Subject to these modifications, statutory net income is commercial net income. . . ." Treas. Reg. 111, Sec. 29.21-1. "Business expenses deductible from gross income include the ordinary and necessary expenditures directly connected with or pertaining to the taxpayer's trade or business. . . ." Treas. Reg. 111, Sec. 29.23(a)-1. Or, as this Court has said, "The purpose here is to tax earnings and profits, less expenses and losses. If one or the other factor in any calculation is unreal, it distorts the liability of the particular taxpayer to the detriment or advantage of the entire taxpaying group." *Higgins v. Smith*, 308 U. S. 473, 477 (1940). And, as Mr. Justice Black has said, "Taxation on net, not on gross, income has always been the broad basic policy of our income tax laws. Net income may be defined as what remains out of gross income after subtracting the ordinary and necessary expenses incurred in efforts to obtain or keep it." *McDonald v. Commissioner*, 323 U. S. 57, 66-67 (1944).

Hence, although Congress may not have allowed the deduction from gross income of all trade and business expenses, it has at the very least, allowed since 1918 all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any business (see *Higgins v. Commissioner*, 312 U. S. 212, 215 (1941)) and "'general equitable considerations' do not control the question of what deductions are permissible." *U. S. v. Olympic Radio and Television, Inc.*, 349 U. S. 232, 236 (1955). If equitable considerations do not control what deductions are permitted, they do not dictate what ones are to be disallowed. *Lewyt Corporation v. Commissioner*, 349 U. S. 237, 240 (1955). "Their extent depends upon the legislative policy expressed in the fair and natural mean-

ing of [Section 23]." *Lykes v. U. S.*, 343 U. S. 118, 120 (1952). And just as equitable considerations can neither expand nor restrict the scope of the statutory deduction, similarly public policy considerations should not be permitted to do so.

c. Meaning and Application of Ordinary and Necessary.

It is recognized that the statutory language necessarily opens up a wide field for interpretation, as the line is drawn from case to case between what is and is not an "ordinary and necessary" business expense within the meaning of Section 23(a)(1)A. *Commissioner v. Weisman*, 197 F. 2d 221, 226 (C. A. 1, 1952). But this Court has circumscribed the boundaries of such examination. Where an expenditure "is directly connected with" or "proximately resulted" from business, it is a business expense. *Kornhauser v. U. S.*, 276 U. S. 145, 153 (1928). The expense is an ordinary one when it is "normal, usual or customary" in the industry (*Deputy v. du Pont*, 308 U. S. 488, 495 (1940)), when the "transactions from which they arose were of common or frequent occurrence in the type of business involved." *Lilly v. Commissioner*, 343 U. S. 90, 93 (1952). Finally, this Court has held that an expense is "necessary" if it is "appropriate and helpful" in the conduct of the business concerned (*Commissioner v. Heininger*, 320 U. S. 467, 471 (1943)), with this Court "slow to override" the taxpayer's "judgment." *Welch v. Helvering*, 290 U. S. 111, 113 (1933).

Tested by these standards, and absent any judicial gloss of "public policy," it is obvious that petitioner's payments pertaining to the three types of fines fell well within Section 23(a)(1)A. Indeed the Court of Appeals so conceded when it observed that "certain expenditures otherwise ordinary and necessary under Section 23(a)(1)A of the Internal Revenue Code of 1939 are not deductible if their allowance would frustrate sharply defined national and state policies . . . ." (R. 139).

Taking up the three types of fines separately, there is no dispute that it was a common, wide-spread, and long-established practice in the industry of transporting bulk liquids by motor vehicles in Pennsylvania to fill the standard size semi-trailer tanks to capacity, causing the equipment carrying anything but gasoline to exceed the exceedingly low Pennsylvania maximum gross weight requirement (R. 118a). The payments by petitioner of fines imposed on each of its Pennsylvania overweight vehicles stopped by the authorities in the taxable year were in the same respective statutory amounts as those imposed on the vehicles of all other carriers in the industry for similar violations. Under union negotiated contracts with its employee drivers, petitioner was obligated to indemnify the drivers, and consequently did pay the fines imposed on the drivers for the overweight vehicles. The other carriers did likewise (R. 128a). Accordingly, the operation of motor vehicles which exceeded the Pennsylvania limit, from which the fines arose, was of common and frequent occurrence in the type of business involved. The payments of the Pennsylvania fines were thus "ordinary" in the generally accepted meaning of the word for purposes of Section 23(a)(1)A.

The payments of the Pennsylvania fines likewise were "necessary" in the generally accepted meaning of that word. As the Tax Court found, only by operating equipment filled to capacity, which caused the equipment to be overweight in Pennsylvania, was petitioner able to remain in business (R. 124a). The rate structure was predicated upon capacity loading of the standardized equipment. Smaller loads would have caused petitioner to operate at a loss. An increase in rental to compensate for the reduced loads would have referred the business to competitors. Furthermore, partially loaded tanks created a hazard to the safety of the operation. Acquisition of smaller equipment to cover the safety problem would have been uneco-

necessary" imply "a condition that the payments themselves must not be illegal." *Boyle, Flagg and Seaman, Inc.*, 25 T. C. 43, 50 (1955). Under this view, which has as its basis the discredited notion that "the law will not recognize the necessity of engaging in illegal courses in the conduct of a business," both the Tax Court and the Courts of Appeals have at various times held that "expenditures which are wrong in themselves or which violate Federal or State law do not qualify as ordinary and necessary business expenses under the statute." *Boyle, Flagg and Seaman, Inc., supra*, at 50. Thus the amounts paid in splitting insurance premiums by an insurance broker with non-licensed automobile dealers for soliciting insurance for it, were held non-deductible by reason of the violation of the insurance laws of Illinois, even though it was the common practice of Illinois insurance brokers to make such payments, and the automobile dealers would not have referred their business to the taxpayer unless it made such payments.

Without considering whether the payments frustrated public policy, the Tax Court relied on what it called a different, although related, line of decisions and preferred to base its decision on the illegality of the expenditure. The Tax Court has believed that this "illegality" of expenditure test finds support in such cases as *Gallatin Farmers Co. v. Commissioner*, 132 F. 2d 706 (C. A. 9, 1943) (Patronage dividends paid in violation of state law); *Rugel v. Commissioner*, 127 F. 2d 393 (C. A. 8, 1942) (Payments to influential party precinct captain in order to obtain a state printing contract); *T. G. Nicholson*, 38 B. T. A. 190 (1938) (Payments made to state senator for his political influence in obtaining favorable conditions covering the bidding on a public contract); *Eastern Tractor & Equipment Co., Inc.*, 35 B. T. A. 189 (1936) (Commissions paid for personal influence in obtaining public contracts). It should be noted that not even "illegality" is

nomical from the revenue standpoint, and financially hazardous in view of the legislation which was periodically proposed to the Pennsylvania legislature to increase the weight limitation to conform to that of the neighboring states. The smaller equipment likewise would have been worthless for the interstate operations, where the neighboring states allowed the larger sized equipment to be utilized fully (R., 125a-126a).

Petitioner consciously chose to conform to the economic realities of the low discriminary Pennsylvania weight law and to stay in business. The continuance of the practice of operating overweight equipment in Pennsylvania was necessary to petitioner's continued business existence. Hence, the payments, pursuant to the union negotiated agreements, of the Pennsylvania fines imposed on its employee-drivers, were as appropriate, helpful and essential as petitioner's other business expenses. They were directly connected with and proximately resulted from the business. Accordingly, they constituted "necessary" business expenses within the meaning of Section 23(a)(1)A.

Similarly, it was necessary that petitioner's and the industry's fleet of equipment be utilized in interstate operations in states other than Pennsylvania. In all instances for which petitioner was fined in New Jersey, the vehicles, although they were under the 60,000-pound limit otherwise permissible in New Jersey, were in excess of the exceedingly lower Pennsylvania limit permitted by Pennsylvania law and were therefore in violation of the reciprocity provision of the New Jersey law (R. 119a, 133a). The payments of fines in the other neighboring states in and through which petitioner's vehicles operated interstate pertained to violations which were neither wilful nor negligent, and the fines were incurred despite every precaution that could fairly be demanded consistent with a practical operation of the business (R. 122a-123a, 127a, 134a). All these violations were of sufficient frequency to the petitioner and to the industry

the alleged test since, despite the admonition in *Lilly* that if a public policy test is to be applied, the policy must be evidenced by a legislative declaration, the expenditures assertedly can be disallowed as "wrong in themselves." But it is not clear whether it is the respondent or the courts which are supposed to sit in judgment on the morality of the taxpayer. This Court in the *Lilly* case found that kick-backs by opticians to physicians for referring patients to them for eyeglasses were deductible. These look "wrong in themselves." The respondent attacks bribes and political influence, yet himself rules that kickback and bribe payments to induce employees or agents of customers to promote purchases by the customers, or to officials of foreign governments, are deductible. Rev. Rul. 54-27, 1954-1 Cum. Bull. 44; Sp. Ruling, March 11, 1957, 103 Cong. Rec. 11232 (1957 CCH Stand. Fed. Tax Rep., Vol. 5, ¶ 6654). And the Tax Court finds nothing wrong in bribes or kickbacks to ship captains and officers by companies in the ship chandlery business. *Frank Valetti* 28 T. C. No. 75 (1957). These are not illegal and not in violatio. f what would appear to be applicable state statutes, so it is said, since they are made with the knowledge and assent of the ship owner. *Fiambolis v. U. S.* (E. D. S. C., 1957 CCH Stand. Fed. Tax Rep., Vol. 5, ¶ 9805). A tax law that turns on these gymnastics substitutes form for substance.

When examination is made of the deductibility of expenditures incurred in illegal businesses, the unfairness of disallowing the instant fines on the variant of public policy becomes even more apparent. The argument is not as the Tax Court in *Boyle, Flagg and Seaman, Inc., supra*, at p. 50 tried to pitch it, that since fines and penalties imposed for activity in violation of state statutes cannot be deducted, the expenditures in the activity itself are likewise non-deductible, but instead it is more properly pitched to the fact that since these expenditures are themselves deductible, clearly the more so are the fines and penalties. The cases of *Ross, Sullivan and Mesi v. Com-*

to render them ordinary. The inadvertent ones resulted from the accepted practice in the industry to load by gallons and to continue in transit despite temperature changes or breakdown, by the use, in the latter instance, of substitute equipment (R. 122a-123a). The New Jersey violations resulted from the accepted and necessary practice in the industry to fully utilize the standard equipment in interstate operations. Hence, the fines pertaining to all of these violations were appropriate, helpful and necessary. In short, they were deductible under the statute.

Thus, it develops that the crucial question is whether the normal, customary and essential expenses involved in petitioner's completely lawful and legitimate business are deprived of deductibility because they were brought about by business activity, necessarily compelled on the industry as a whole, which Pennsylvania and the other states declared to be subject to fine. It is not at all relevant to consider whether Congress, had it chosen, might have excluded expenses incurred directly in violation of state law or fines incidental thereto from permissible deductions, or imposed a tax upon a different definition of net income in respect to businesses in violation of some aspect of state law. Sufficient it is that Congress has not done so, but has taxed only the net income which remains after the deduction of all ordinary and necessary expenses in carrying on the business. "The revenue act was not contrived as an arm of the law to enforce State criminal statutes by augmenting the punishment which the State inflicts." *Burroughs Building Material Co.*, 18 B. T. A. 101, 105 (1929).

In support of the disallowance the respondent and the courts below have insisted that to allow the tax deduction for the fines in some way reduces and so, in part, defeats the prescribed state punishment. This is an entirely specious argument because it overlooks the bald fact that the denial of the tax deduction, on the other hand, augments and increases the so-called state punishment by imposing a

tax on monies which petitioner was forced to expend and could not retain. Thus, the denial of the tax deduction is in reality the imposition of a double penalty never contemplated by the state when it fixed the fine in a definite amount, regardless of the wealth or poverty of the violator. There is no reason to assert judicially, in the absence of congressional legislation specifically dealing with the matter, that Congress under the language of Section 23(a)(1)A intended to impose such double penalty.

d. *The Heininger and Lilly Cases.*

Petitioner submits that there is no warrant in the opinions of this Court in *Heininger* and *Lilly* for the assertion of the respondent and the courts below that this Court has approved any "judicial gloss" of "public policy." In *Heininger*, this Court noted that "The Bureau of Internal Revenue, the Board of Tax Appeals, and the federal courts have from time to time, however, narrowed the generally accepted meaning of the language used in Section 23(a) in order that tax deduction consequences might not frustrate sharply defined national or state policies proscribing particular types of conduct." 320 U. S. at 473. Then the opinion pointed out that "The language of Section 23(a) contains no express reference to the lawful or unlawful character of the business expenses which are declared to be deductible." Following this, the opinion accepted the disclaimer in the government's brief of "any contention that the purpose of tax laws is to penalize illegal business by taxing gross instead of net income." 320 U. S. at 474. Plainly, this latter observation does not endorse any public policy doctrine that expenses incidental to unlawful business activity or in violation of law are not deductible. For, as will be discussed in more detail later, under any such theory, illegal businesses or activities should not be allowed any deductions at all, even of strictly so-called legitimate expenses, since they frustrate the state policy to prevent the prohibited activity. Hence, rather than approving a

public policy limitation, the opinion of this Court in *Heininger* casts grave doubts on its use.

Furthermore, in *Lilly* this Court again took great pains to point out that "There is no statement in the Act or in its accompanying regulations prohibiting the deduction of ordinary and necessary business expenses on the ground that they violate or frustrate 'public policy'." 343 U. S. at 94. Then this Court was most careful merely to observe, but not to approve, that it could be argued with respect to expenditures which themselves violated a federal or state law or were incidental to such violations, such as penalties for unlawful conduct and legal fees incident to the defense of a taxpayer against charges of illegal conduct, that the outlawed expenditures, "by virtue of their illegality," were not ordinary and necessary business expenses within the meaning of Section 23(a)(1)A (p. 94-95). At most, this Court would assume "for the sake of argument that, under some circumstances, business expenditures which are ordinary and necessary in the generally accepted meanings of those words, may not be deductible as 'ordinary and necessary' expenses under Section 23(a)(1)A when they 'frustrate sharply defined national or state policies proscribing particular types of conduct'." (pp. 96-97)

But no such situation was before this Court in the kickbacks by the opticians to the physicians. Rather than justification for the assumption that this Court would disallow deduction of an illegal expense if it were established that such an expense were ordinary and necessary, it would seem, to the contrary, that the opinion indicates that any test based on illegality or public policy must be abandoned as a judicial guide.

An examination of the numerous decisions in the field reveals only utter confusion and inconsistency resulting from the judicial attempt to disallow otherwise ordinary and necessary business expenses when they "frustrate sharply defined national or state policies proscribing par-

ticular types of conduct," even when the admonition of this Court that such policies must be "evidenced by some governmental declaration of them" is strictly observed. *Lilly v. Commissioner*, *supra* at 97. It reveals that there can be no workable rule or legal theory used, in the absence of definitive legislative standards, which can justify the disallowance of the deduction.

c. Fines and Legal Fees Incident Thereto.

One category of cases lies in the penalty or fine type of situation involved in the instant case. Prior to *Heininger*, no distinction was made by the lower courts as to the non-deductibility of fines and penalties, on the one hand, and legal expenses incurred in an unsuccessful effort to prevent their collection, on the other hand. *Helvering v. Superior Wines and Liquors, Inc.*, 134 F. 2d 373 (C. A. 8, 1943); *Burroughs Building Material Co. v. Commissioner*, 47 F. 2d 178 (C. A. 2, 1931). "If it is never necessary to violate the law in managing a business, it cannot be necessary to resist a decree in equity forbidding violations, except in cases where an injunction is unjustified. There is indeed less to be said for spending money in that way than in defending a criminal prosecution, for the decree by hypothesis will do no more than forbid what the taxpayer ought not to do anyway." *National Outdoor Advertising Bureau, Inc. v. Helvering*, 89 F. 2d 878, 881 (C. A. 2, 1937). "... we can see no relevant distinction between [payment of fines and forfeitures] and legal expenses incurred in an unsuccessful effort to prevent their collection. Indeed, to hold otherwise would be to subsidize the obduracy of those offenders who were unwilling to pay without a contest and who therefore added impenitence to their offenses ...." *Jerry Rossman Corp. v. Commissioner*, 175 F. 2d 711, 713 (C. A. 2, 1949). Hence, when this Court allowed in *Heininger* the deduction for attorney fees paid in good faith for unsuccessfully resisting the issuance by the Postmaster General of a "fraud order" which would destroy the

axpayer's business, a substantial tenet of the penalty doc-
rine was overruled—the doctrine as expressed in *National
Outdoor Advertising Bureau, Inc. v. Helvering, supra,* at
81, that "the law will not recognize the necessity of engag-
ng in illegal courses in the conduct of a business."

Plainly, this Court in *Heininger* made no real dis-
inction between legal expenses, on the one hand, and fines
r penalties, on the other. And none there can be. Penal-
ies and attorney fees stand on the same footing. We
elieve this Court recognized this from the citation of both
ypes of cases interchangeably in footnote 8 on page 473
f the opinion. Indeed, the Tax Court was willing to ac-
ept this interpretation when it allowed as deductions both
he attorney fees for the unsuccessful defense and the
enalties paid to the state of Texas under a consent decree
or violations of that state's anti-trust laws. *Longhorn
Portland Cement Co.*, 3 T. C. 310 (1944). But the Court of
Appeals for the Fifth Circuit reversed the deductibility of
he penalty payment, without regard to the guilt or in-
nocence of the taxpayer, saying, "the ultimate determina-
ive inquiry upon this appeal is whether the deduction
claimed was paid as a penalty." *Commissioner v. Long-
horn Portland Cement Co.*, 148 F. 2d 276, 277-278 (C. A.
5, 1945), certiorari denied, 326 U. S. 728.

The Treasury has felt that the rationale of *Heininger*
and *Longhorn Portland Cement Co.* is such that the at-
torney fee deduction is allowable for the unsuccessful de-
fense of criminal anti-trust proceedings, apparently without
regard as to whether there is any frustration of the public
policy expressed in the Sherman Act. GCM 24377, 1944
Cum. Bull. 93; see also GCM 24810, 1946 Cum. Bull. 55.
(Attorney fees deductible in unsuccessful defense of civil
actions of O. P. A. regulations providing for treble dam-
ages.) But in the Treasury's position, the penalty itself
remains undeductible.

However, if frustration of national or state policies
evidenced by governmental statutes is the proper touch-

stone of non-deductibility, there can be no relevant distinction, as already observed, between the fines and penalties imposed and the legal expenses incurred in an unsuccessful defense to prevent their collection. To allow one and not the other is completely unwarranted.

f. Necessary Public and Private Wrongs.

Another inexplicable aspect of the fine or penalty situation lies in the strained observations that "the law will not recognize the necessity of engaging in illegal courses in the conduct of a business" (*National Outdoor Advertising Bureau, Inc. v. Helvering*, 89 F. 2d 878, 881 (C. A. 2, 1937) referring to *Burroughs Building Material Co. v. Commissioner*, 47 F. 2d 178 (C. A. 2, 1931) (Fines and attorney fees for violations of state price fixing laws)); and that it "cannot be that Congress intended the carrier should have any advantage, directly or indirectly, or any reduction, directly or indirectly, of these penalties." *Great Northern Ry. Co. v. Commissioner*, 40 F. 2d 372, 373 (C. A. 8, 1930), certiorari denied, 282 U. S. 855, (Penalties assessed on railroad for violations of Safety Appliances Act and Hours of Service Law, which arose in connection with the operation of the road).

Complicated and involved statutes and regulations present a common hazard in today's ordinary business life. Violations become a common business risk and penalties incurred in the ordinary course of business a normal cost of doing business. Thus, a partial recognition of the complexities in which the business world operates has been recognized in the line of cases holding that payments to the government for good faith unintentional violations of the Emergency Price Control Act are deductible (*Jerry Rossman Corp. v. Commissioner*, 175 F. 2d 711 (C. A. 2, 1949); *National Brass Works, Inc. v. Commissioner*, 182 F. 2d 526 (C. A. 9, 1950); *Pacific Mills v. Commissioner*, 207 F. 2d 177 (C. A. 1, 1953)), although they cannot be treated as deductible expenses if the violations were in-

urred deliberately or were avoidable. *George Schaefer & ons, Inc. v. Commissioner*, 209 F. 2d 440 (C. A. 2, 1954); *entin v. Commissioner*, 226 F. 2d 695 (C. A. 7, 1955), ertiorari denied, 350 U. S. 934; *National Brass Works, nc. v. Commissioner*, 205 F. 2d 104 (C. A. 9, 1953). Even nder this view, there was no rational reason for the courts elow to disallow the fines for the admittedly unintentional nd inadvertent violations of the weight laws of the states ther than Pennsylvania and New Jersey, where the vioations took place despite every precaution that could easonably be required of a prudent motor carrier to comly with the weight limitations involved (R. 134a).

But the judicial dichotomy on deliberateness or avoidbility in the role of preventing "frustration" cannot be ustified by the numerous decisions where the courts have epeatedly held that a taxpayer may deduct damages paid o a private person because of a wrong or tort committed n the operation of his business. Penalties for such private rongdoing are just as unnecessary and avoidable, and the rongs may have been committed with as much wilfulness nd deliberateness as those involved or pertaining to public rongdoing. The deduction of the expenses of the former rustrates the public policy expressed in numerous state tatutes as much as the deduction of the fine imposed by governmental body, where there is deliberate, intentional r other tortious conduct. Nevertheless, the courts have onsidered it immaterial whether the injury was caused y negligence, conspiracy, misrepresentation, conversion or iolation of a statute. *James E. Caldwell & Co. v. Comissioner*, 234 F. 2d 660 (C. A. 6, 1956) (Milking and disipating corporate assets by conspiracy and fraud); *Becker Bros. v. United States*, 7 F. 2d 3 (C. A. 2, 1925) (Infringeent of patent); *Helvering v. Hampton*, 79 F. 2d 358 (C. A. , 1935) (Fraud); *Anderson v. Commissioner*, 81 F. 2d 457 C. A. 10, 1936) (Negligence resulting in death); *H. M. Howard*, 22 B. T. A. 375 (1931) (Misrepresentation and

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conspiracy); *W. R. Hervey*, 25 B. T. A. 1282 (1932) (Violation of usury laws); *International Shoe Co.*, 38 B. T. A. 81 (1938) (Conspiracy); *Robert S. Farrell*, 44 B. T. A. 238 (1941) (Unlawful acts as director); *William Ziegler, Jr.*, 5 T. C. 150 (1945) (Mismanagement of corporation); *Dixon Fagerberg*, 1942 P-H. B. T. A. Memo. Dec. § 42,091 (Conversion of corporate assets).

In *Helvering v. Hampton*, 79 F. 2d 358, 360-361, (C. A. 9, 1935), the Court of Appeals said, "We cannot agree that private wrongdoing in the course of business is extraordinary within the meaning of the taxing statute allowing deductions for 'ordinary and necessary expenses'. The statute itself makes no exception . . . even if unethical conduct in business were extraordinary, restitution therefor is ordinarily expected to be made from the person in the course of whose business the wrong was committed." Similarly, public wrongdoing in the nature of violations of state statutes is not extraordinary within the meaning of Section 23(a)(1)A, and the fine legally and lawfully required to be paid for the transgression surely is not.

Furthermore, attempting to distinguish between penalty for a public wrong and restitution for a private wrong has led the courts into an insoluble maze. In *Standard Oil Co. v. Commissioner*, 129 F. 2d 363, 371 (C. A. 7, 1942), the Court finds the line of demarcation shadowy between deductibility of private and public tort judgments, yet believed it tolerably safe to say that torts committed against the government which are also violative of the criminal statutes may not furnish the basis of a tax deduction. The tort suit was brought by the United States to collect restitutionary damages for oil taken in the Teapot Dome scandals. The Court in *Foss v. Commissioner*, 75 F. 2d 326 (C. A. 1, 1935) saw a distinction which the Second Circuit in *National Outdoor Advertising Bureau, Inc. v. Helvering*, 89 F. 2d 878, 881 (1937), could not, between the unsuccessful defense of a suit by a minority shareholder to

enjoin the unlawful conduct of the taxpayer and a suit brought by the Sovereign. The Treasury could see this distinction, unobserved by the Second Circuit, when it ruled that amounts paid on acount of actions instituted or proposed to be instituted for violations of the Emergency Price Control Act, when the violations were not wilful or the result of failure to take practical precautions to prevent their occurrence, were deductible if paid to the consumer, but not if paid to the United States. IT 3627, 1943 Cum. Bull. 111; IT 3799, 1946-1 Cum. Bull. 56. On the other hand, the Treasury made no moment as to any distinction based on suit being brought by the government rather than a private person when it ruled that amounts paid as liquidated damages by an employer to the United States under the Walsh-Healey Public Contracts Act (49 Stat. 2036) with respect to minimum wage and overtime violations were deductible for tax purposes, but not if paid with respect to child labor violations. I. T. 3894, 1948-1 Cum. Bull. 28.

In addition, not only is it fictitious to attempt to differentiate between public and private wrong on the ground of public or private party plaintiff, but any reliance that the distinction finds basis in a "restitution" concept as opposed to "penalty" can find no support in the nondeductible settlement involved in *Standard Oil Co. v. Commissioner, supra*, which was the fair equivalent of the loss sustained, or in the deductible innocent OPA violation payments made to the United States in *National Brass Works, Inc. v. Commissioner*, 182 F. 2d 526 (C. A. 9, 1950) where the Court, in finding such a distinction between restitution and penalty of no merit said (p. 530): "However, if we had to decide the nature of the damage payments to the government under Section 205(e), we would liken them to penalties for the reasons expressed in *Porter v. Montgomery*, 3 Cir., 1947, 163 F. 2d 211. We doubt that Section 205(e) was in any respect intended to provide for restitution."

Moreover, the deduction of damages imposed for torts reduces and mitigates the sanction imposed on the tort-feasor for the wrongful conduct as much, if not more, than the deduction of a fine or penalty. The respondent himself, on occasion, has argued against any such distinction and has contended that in both cases public policy is equally involved and violated. See *Helvering v. Hampton*, 79 F. 2d 358, 359 (C. A. 9, 1935); *International Shoe Co.*, 38 B. T. A. 81, 95 (1938). Furthermore, petitioner reads this Court's opinion in *Heininger* to eradicate any distinction between public and private wrongs in connection with the deductibility of legal fees involved in unsuccessful defenses. At 320 U. S. page 472 the opinion states, "Surely the expenses were no less ordinary or necessary than expenses resulting from the defense of a damage suit based on malpractice, or fraud, or breach of fiduciary duty. Yet in these latter cases legal expenses have been held deductible without regard to the success of the defense." Hence, as the Second Circuit, in referring to the fact that the fines involved in *Great Northern Ry. Co. v. Commissioner*, 40 F. 2d 372 (C. A. 8, 1930), certiorari denied, 282 U. S. 855, were for violations of a kind which were not infrequent, were inevitable in any large railroad system and for that reason may reasonably be allowed as ordinary and necessary expenses of the business, stated in *Burroughs Building Material Co. v. Commissioner*, 47 F. 2d 178, 180 (C. A. 2, 1931), "It is not easy to distinguish such fines from expenditures incurred in connection with actions to recover for negligence or because of patent infringements, *unless one draws an arbitrary line* between criminal and civil actions, even where the criminal actions relate to matters involving no moral turpitude." (Italics supplied.) It should be observed that this thought is the very rationale of the letter ruling of the respondent allowing the deduction of fines incurred and paid by motor carriers for violations of the maximum weight laws of the states during the period 1942-1950 (App. 9a-12a).

But, there is no justification for the drawing, as implied in *Burroughs Building Material Co. v. Commissioner*, *supra*, of any "arbitrary line." If any line is to be drawn in the public policy field, it must be a rational one and then drawn not by the judiciary, but by the proper legislative authority. This Court's opinion in *Textile Mills Securities Corp. v. Commissioner*, 314 U. S. 326 (1941) is not opposed to this conclusion. There this Court recognized that the "words 'ordinary and necessary' are not so clear and unambiguous in their meaning and application as to leave no room for an interpretive regulation" (p. 338) and that the general policy indicated by cases condemning contracts to spread insidious influence through legislative halls "need not be disregarded by the rule-making authority in its segregation of non-deductible expenses" (p. 339). Hence, a regulation which barred the deduction of amounts spent for "lobbying" as ordinary and necessary expenses was sustained, in the absence of any indication that such a course contravened any congressional policy, since a line could be drawn "between legitimate business expenses and those arising from that family of contracts to which the law has given no sanction" (p. 339). The regulation made no mention of public policy and did not distinguish between legitimate lobbying contracts and the illegitimate variety. It determined rather that lobbying expenses, regardless of their nature, are not deductible ordinary and necessary expenses, and this Court found it immaterial whether the precise arrangement there in question would have been condemned under the case law.

In the case at bar, however, there is neither absence of indication of contrary congressional policy nor presence of any interpretive regulation applicable to the instant fines and penalties. In fact, the regulations recognize an aspect of the problem when they expressly provide that "Penalty payments with respect to federal income taxes, whether on account of negligence, delinquency or fraud are not de-

ductible from gross income." Treas. Reg. 111, Sec. 29.23(a)-1. This provision was put into the regulations, possibly as a result of *U. S. v. Jaffray*, 97 F. 2d 488 (C. A. 8, 1938), affirmed on another ground, 306 U. S. 276 (1939), which pointed up the previously changing position of the Treasury on the point. The Treasury was aware of *Great Northern Ry. Co. v. Commissioner, supra*, and *Burroughs Building Material Co. v. Commissioner, supra*, yet made no attempt to add their rule to the regulation at the time the provision dealing with penalties for federal tax violations was added. See G.C.M. 11358, XII-1 Cum. Bull. 29 (1933). If the Treasury did not, there is no reason for the courts to do so.

g. *Activity in Violation of State Law.*

If "frustration of state legislative policies proscribing particular types of conduct" can be a proper basis for non-deductibility, there can be no logic in disallowing the fines for the overweight violations presented here without similarly attacking the motor vehicle expenses, depreciation and salaries paid in the commission of the so-called unlawful activity of operating the overweight vehicles. Surely all are equally dedicated to the activity which, under the view of the respondent and the courts below, the states seek to prevent. And similarly, if there can be deducted the integral unlawful expenses of an illegal business, morally wrong and socially condemned (*Commissioner v. Doyle*, 231 F. 2d 635 (C. A. 7, 1956); *Sullivan and Ross v. Commissioner*, 241 F. 2d 46 (C. A. 7, 1957); *Mesi v. Commissioner*, 242 F. 2d 559 (C. A. 7, 1957) (writs of certiorari granted to the Court of Appeals for the Seventh Circuit)), the transgressions of a socially desirable legitimate business cannot properly be singled out for tax punishment by the disallowance of expenses, otherwise ordinary and necessary, which may be incidental thereto.

The culmination of this type of confusion and chaos is the emasculation of the statutory test of "ordinary and

necessary". This finds expression in the address of Attorney General Herbert Brownell to the American Bar Association annual meeting on August 27, 1953. The Attorney General stated (78 ABA Rep. 334, 338 (1953)):

> "It seems anomalous that a person engaged in a business which is admittedly illegal may take a deduction for 'ordinary and necessary expenses' incurred in the business. As either a legal or practical matter, I can see nothing ordinary or necessary in expenses incurred in long distance telephone calls made to place bets or make layoffs; automobile expenses for collecting numbers or delivering dope, rent for houses used for gambling, or other vice. But, even if they are "ordinary" expenses, there is certainly nothing 'necessary' about them.
>
> "Our policy in the Department will henceforth be to disallow all deductions for expenses incurred in illegal enterprise, and the Treasury Department has promised us its fullest cooperation."

Although the Attorney General was speaking in the context of "professional criminals," the policy proposed, with which the Treasury will fully cooperate, is to use the tax laws, not only for revenue purposes, but also for suppression of local crime by disallowing "all deductions for expenses incurred in illegal enterprise." When lawful business transgresses the law, it is a short step for respondent, unless checked, to separate lawful from unlawful activity and cast the latter into the category of "illegal enterprise." And the step is short because the public policy doctrine has been allowed to erode the plain meaning of Section 23(a)(1)A.

The cases are replete with illustrations of this erosion. Not only are they floundering in the quicksand of public policy, but they have reached the point, apparently without regard to public policy, that the words "ordinary and

missioner, supra demonstrate that otherwise ordinary and necessary expenses, even of an illegal business, are to be given income tax recognition, even though the payments made in and of themselves be illegal and wrongful under state statute, and even though the allowance of any expenses to such illegal business mitigates against the state statute forbidding the business enterprise itself. In the intant case, there was nothing morally wrong or illegal in and of itself for the petitioner to pay the fines directly imposed on it by New Jersey and the other states, and in Pennsylvania there has been no contention, as indeed no meritorious one could be advanced, that the union negotiated contracts obligating petitioner to indemnify and reimburse its drivers for the Pennsylvania fines imposed on the drivers operating the overloaded vehicles, were illegal or even approached that "family of contracts to which the law has given no sanction." Hence moral turpitude, illegality, and the like, whatever their relevance in other cases, constitute no barrier to the deductions sought here.

"Frustration" thus looms in paramount importance, but, as already observed, the expenses lawfully and legitimately incurred by petitioner in operating its overweight vehicles were as directly connected with the overweight violations as the fines imposed. The logic of the Attorney General's position is inescapable, once his unsound premise is accepted that a purpose of the Revenue Act is to suppress crime. It may be paraphrased as follows: Disallow the illegal expenses of an illegitimate business; they frustrate public policy. Then disallow the legitimate expenses also; they frustrate public policy by allowing the illegitimate business tax recognition. Then separate the transgressions of a legal business and give them no tax deductibility recognition. Tax gross instead of net income.

h. *Abandonment of Public Policy Test.*

"Moral turpitude is not a touchstone of taxability." *Commissioner v. Wilcox*, 327 U. S. 404, 408 (1946); "The

1916 Amendment [omitting the word "lawful" before the word "business" in the definition of gross income] demonstrated an intent to include gains, profits and income from any unlawful business as well as from any lawful business. It is inescapable evidence of a like intent to include unlawful as well as lawful 'gains . . . from any source whatever'." *Commissioner v. Wilcox, supra*, at 411. See *U. S. v. Sullivan*, 274 U. S. 259 (1927). Cf. *Rutkin v. U. S.*, 343 U. S. 130, 141 (1952). But the tax laws do not "penalize illegal business by taxing gross instead of net income." *Commissioner v. Heininger*, at 474. "By the broad definition of gross income, income arising from an illegal business is taxed even though the illegality be one declared by the Constitution itself. . . . The provisions of the statute fixing the deductions to be regarded in arriving at net income which alone is taxed . . . are as broad and unqualified as those defining the taxable gross income." *Alexandria Gravel Co. v. Commissioner*, 95 F. 2d 615, 616 (C. A. 5, 1938). Whatever vitality may still exist in the restrictive interpretation that allowance of a deduction "depends upon legislative grace; and only as there is clear provision therefor can any particular deduction be allowed" (*New Colonial Ice Co., Inc. v. Helvering*, 292 U. S. 435, 440 (1934)), in view of the treatment afforded this rule in *Lykes v. U. S.*, 343 U. S. 118, 120 (1952) (footnote 4), it is the respondent and the lower courts which have ignored the "clear provision" of the ordinary and necessary business expenses here involved by reliance on the extra-statutory concept of public policy. It may shock the conscience of many to find an otherwise reputable businessman in violation of law, but this does not justify applying the alien concept of public policy in the almost mathematical computation of net income. A taxpayer cannot deny his receipt of income on the ground it resulted from illegal transactions; but neither should the respondent be permitted to find the existence of taxable income where there is none merely on the ground of some public policy.

ness deductions, which policy was unchanged by congressional amendments to the Internal Revenue Code during this period, and that he was in error in revoking it by his November 30, 1950 ruling (App. 12a). The place of the fine in the Pennsylvania weight law, being imposed on the employee-driver, and the studied enforcement policy of the Pennsylvania authorities to accept the fine and allow the vehicle to continue overloaded without requiring that the excess load be removed, indicates that the factual premise on which respondent's earlier deductible ruling was based continued to be present in Pennsylvania in the taxable year. If the fine were really a revenue or remedial measure, as petitioner claims it was, there can be no serious question as to its deduction not frustrating any sharply defined Pennsylvania state policy.

In this connection, the Tax Court observed that it was highly doubtful whether Pennsylvania would have granted a permit to a bulk liquid motor carrier to exceed the permissible limit (126a, 131a), and respondent may seek to draw some comfort from this observation. However, the fact that a permit would or would not have been granted in Pennsylvania had petitioner or the other carriers sought one for each overloaded vehicle is completely beside the point. What is important is, as respondent himself had recognized in his earlier ruling, that where continued operation of the overloaded equipment on the highways is freely permitted, either by way of payment of fine, or by way of permit, the cost of such continued operation, in the form of fine or permit, is a deductible business expense, which does not frustrate any sharply defined policies of the weight limitation laws.

Hence, the payment in the form of a fine does not per se outlaw the deduction. All the facts in the instant case pertaining to the scheme of the fine in the enactment and enforcement of the Pennsylvania weight law lead to the conclusion that it was a remedial measure to compensate

This has been partly recognized, over respondent's strenuous objections, in the fictitious distinction which is said to exist between the determination of gross income, on the one hand, and deductions allowed to the taxpayer, on the other. Illegal payments, such as those in excess of O. P. A. ceiling prices, and kickbacks on the selling price in violation of state statutes, must be recognized in the computation of gross income as part of the cost of goods sold or as a reduction of gross receipts, despite the fact that public policy is flouted as much in these instances as in the cases heretofore holding that illegal payments are not deductible as ordinary and necessary business expenses. *Hofferbert v. Anderson Oldsmobile, Inc.*, 197 F. 2d 504 (C. A. 4, 1952); *Pittsburgh Milk Co.*, 26 T. C. 707 (1956). The whole distinction between gross income and net income seems rather artificial and unnecessary, at least in this field. When it is considered that the clear purpose of income tax law is to tax net, rather than gross, income, even though the technical arrangement of the various statutory provisions permits an argument that gross income and net income require a different approach, the observation that deductions are a matter of legislative grace does not seem helpful or meaningful to justify disregarding the illegal payments. The deductions at least are not a matter of judicial grace. Hence, it is not surprising that the respondent has argued "that the distinction between deductions and cost of goods is lacking in significance, is tenuous and diminishes tax liability unless the distinction is wiped out or disregarded." *Commissioner v. Weisman*, 197 F. 2d 221, 224 (C. A. 1, 1952). And the courts paying lip service to the difference frankly admit that "in some instances this distinction is clear; in other cases, particularly as to manufactured goods, the distinction is often technical and economically obscure." *Hofferbert v. Anderson Oldsmobile, Inc.* 197 F. 2d 504, 506 (C. A. 4, 1952).

Petitioner agrees that the distinction should be wiped out and that the only consistent and realistic approach is to disregard illegality, immorality, and public policy as such and determine tax liability on the basis of the taxpayer's true commercial net income, however it is produced. In arriving at that income, there should be allowed as exclusions or deductions all costs and expenses ordinarily and necessarily incurred in the production of that income. See *McDonald v. Commissioner*, 323 U. S. 57, 66 (1944). That is, the cost and expense which is so clearly interwoven in the fabric of the business as to make fictitious any net income figure computed without regard to them.

This seems to be the general approach taken by the Seventh Circuit in the *Doyle, Ross, Sullivan* and *Mesi* cases, with its emphasis that "ordinary and necessary" expenses mean "those expenses which economically are an integral part of a business, whether it be lawful or not," (*Commissioner v. Doyle*, 231 F. 2d 635, 637 (C. A. 7, 1956)), although some dicta in the *Doyle* case, placing fines and penalties imposed for violation of federal or state statutes in the non-deductible concomitant class, suggests that the Court would hesitate to carry through on its convictions. *Commissioner v. Doyle, supra*, at 637. The expenses incurred by petitioner for the gas, oil, salaries, depreciation, and fines were unquestionably, in Pennsylvania, economically interwoven in the production of over two-thirds of petitioner's income derived from activities in that state (R. 120a). As the Court of Appeals said in the *Heininger* case, "Without this expense, there would have been no business. Without the business, there would have been no income. Without the income, there would have been no tax. To say that this expense is not ordinary and necessary is to say that that which gives life is not ordinary and necessary." *Heininger v. Commissioner*, 133 F. 2d 567, 570 (C. A. 7, 1943).

Of course, abandonment of a public policy test which uses the deduction provision as a medium for judicial ex-

for alleged damage to the roads, allowing the carriers the right to proceed with their overweight vehicles on the Pennsylvania highways without further interference.

Finally, as previously noted, the frustration of not every alleged, vague or inarticulate policy, evidenced by state statute, will deny deductibility of violative fines as ordinary and necessary business expenses. It is only the frustration of "sharply defined" policies. *Lilly v. Commissioner*, 343 U. S. 90 (1952); *Commissioner v. Heininger*, 320 U. S. 467 (1943). The clearly defined policies and underlying purposes of the weight laws of other states are not involved. The fine in the Pennsylvania scheme of enforcement was neither, in fact or intention, punishment for past nor a deterrent to future overweight violations. It was imposed as a remedial measure to cover restitution for supposed damage to the highways of the state. The discriminatory and restrictive limitations were recognized and removed for the future by legislation which, although it was subsequent to the taxable year, nevertheless confirmed previous enforcement policy content to take the fine without removal of the excess load, and to allow the vehicles to continue enroute with weights conforming to those allowed in the neighboring states.

It is, therefore, submitted that petitioner's payments of the Pennsylvania fines imposed on its employee-drivers, pursuant to union negotiated contracts substantially similar to those existing for the other carriers in the industry and placing this obligation on taxpayer, were deductible as ordinary and necessary business expenses.

b. *New Jersey.*

In the seven instances for which petitioner was fined in New Jersey, petitioner's vehicles, although they were under the 60,000 pound limit otherwise permissible in New Jersey, were in excess of the considerably lower Pennsylvania limit permitted by Pennsylvania law and were, there-

fore, in violation of the reciprocity provision of the New Jersey law (119a, 133a).

The reasons advanced by the courts below for nondeductibility of the fines were that the New Jersey violations were just as deliberate as the ones occurring in Pennsylvania itself and that New Jersey had undertaken to accommodate its penal provisions to those of Pennsylvania, making it a criminal offense to operate Pennsylvania vehicles on the New Jersey roads which exceeded the lower Pennsylvania limit (R. 133a, 141).

The Tax Court did not know why New Jersey did this and neither it nor the Court of Appeals attempted to indicate how the allowance of the deduction for the New Jersey reciprocity violations would in any way frustrate the sharply defined policies of either the Pennsylvania or New Jersey state law. This further indicates that the courts below were content to deny the deduction on the mere finding that the payment was a fine.

It is submitted that this is error and frustration which at least must be present to deny deductibility, cannot be shown.

No policies of the Pennsylvania statute would be offended by the operation of vehicles bearing a Pennsylvania license registration on the highways of another state. At best the Pennsylvania weight limitation is designed to protect roads and highways within the state of Pennsylvania. It is not a home port measure, designed to prescribe rules of conduct for the operation of so-called Pennsylvania equipment in the surrounding states of the United States. Nor should it be said that New Jersey, by its reciprocity provision, attempted to help other states effectively police their own weight laws, when the other states did not do likewise for New Jersey.

Similarly, since New Jersey recognized a 60,000 pound legal weight, no sharply defined public policy to protect New Jersey roads or highways was offended by the opera-

pression of moral attitudes, does not mean that all sorts of illegal and immoral expenses would automatically become deductible. The proper statutory criterion of "ordinary and necessary" as interpreted by this Court would still allow most of the objectionable payments which have troubled respondent and the courts to be disallowed. Where it is not "ordinary" in the particular business to give bribes, the courts could still strike down the deduction without regard to public policy. Or payments for political favors may be denied deductibility because others in the business do not consider them necessary. *Rugel v. Commissioner*, 127 F. 2d 393 (C. A. 8, 1942) (Payments to an influential party precinct captain in order to obtain a state printing contract); *Harden Mortgage Loan Co. v. Commissioner*, 137 F. 2d 282 (C. A. 10, 1943) certiorari denied, 320 U. S. 791 (Payments for exerting political influence made under the guise of selling commissions on road building materials); *Excelsior Baking Co. v. U. S.*, 82 F. Supp. 423 (D. Minn., 1949) (Sums surreptitiously paid to disreputable men to negotiate a labor contract). If it were possible that a taxpayer could show that certain bribes and rigged fines were ordinary, necessary and customary for his illegal business, which would not properly be classified as payments for good will, they should be deductible, but the problems of proof would be formidable and the cases so few as to be insignificant. See *Charles A. Clark*, 19 T. C. 48 (1953); *Automatic Cigarette Sales Corp. v. Commissioner*, 234 F. 2d 875 (C. A. 4, 1956) certiorari denied, 352 U. S. 951. But fines are natural, customary, ordinary, and unavoidable in such lawful businesses as taxicab operations and the truck operations of the instant case.

This approach gives no advantage to the illegitimate over the lawful enterprise, as seems to worry respondent at page 14 of his petition for certiorari in the *Sullivan*, *Ross*, and *Mesi* cases. So long as net income is the denominator of taxability, each type of business is separately to be examined. "Normalcy in the particular business" is the

tion of petitioner's Pennsylvania licensed vehicles within such a weight limitation in New Jersey.

Hence, on its face, the role of the fine in the scheme of enforcement of the New Jersey reciprocity provision would seem to be either a revenue measure or as a retaliatory measure directed not against petitioner or the other carriers in the industry, but possibly against the policy of the state of Pennsylvania in imposing its restrictive weight law to New Jersey registered vehicles on the highways of Pennsylvania. Then, the purpose of the fine could be said to be to alleviate the burden which was placed on New Jersey motor vehicles fined in Pennsylvania, by shifting some of the cost of maintaining the New Jersey highways to the Pennsylvania vehicles exceeding in New Jersey the Pennsylvania maximum weight. In any event, however, New Jersey was not concerned in any way in using the fines as a sanction to punish or deter the operation of equipment therein bearing a maximum weight of under 60,000 pounds.

c. *Other States.*

The record indicates that the payments of fines in the other neighboring states in and through which petitioner's vehicles operated pertained to violations which were neither wilful nor negligent, and that the fines were incurred despite every precaution that could fairly be demanded consistent with a practical operation of the business (R. 122a-123a, 127a, 134a).

Here again, the allowance of a deduction for the payments of fines incurred despite the exercise of appropriate care would not frustrate any sharply defined policies of the applicable state weight limitation laws. It may well be, as was pointed out by the District Court in *Hoover Motor Express Co., Inc. v. U. S.*, 135 F. Supp. 818 (D. C. Tenn., 1955) aff'd 241 F. 2d 459 (C. A. 6, 1957) certiorari granted that the purposes of the state weight limitation laws to protect the highways of the state and the persons using them could be accomplished more effectively by treating wil-

proper test (*Deputy v. duPont*, 308 U. S. 488, 496 (1940)), not that it conforms to the standards of the business community as a whole, as respondent has attempted to suggest in his rulings on deductible kickbacks. See I. T. 4096, 1952-2 Cum. Bull. 91; Rev. Rul. 54-27, 1954-1 Cum. Bull. 44. This means that the fines involved in the instant case, arising from customary, normal overweight operations necessary to petitioner's continued business life, meet the statutory standard. Each case must be examined ad hoc. See *Jerry Rossman Corp. v. Commissioner*, 175 F. 2d 711, 713 (C. A. 2, 1949). ". . . where the benefit claimed by the taxpayer is fairly within the statutory language and the construction sought is in harmony with the statute as an organic whole, the benefits will not be withheld from the taxpayer . . ." *Lewyt Corporation v. Commissioner*, 349 U. S. 237, 240 (1955).

The tax laws are to be interpreted so as to have a uniform application in the states of the United States. *Burnet v. Harmel*, 287 U. S. 103, 110 (1932); *U. S. v. Pelzer*, 312 U. S. 399, 402 (1941). "Were it not so, federal tax legislation would be the victim of conflicting state decisions on matters relating to local concerns and quite unrelated to the single uniform purpose of federal taxation." *Estate of Rogers v. Commissioner*, 320 U. S. 410, 414 (1943). State laws vary far too much in their scope and operation to allow the "single uniform purpose" of taxing commercial net income to be dependent on state whim or to justify federal interference "into fields of law enforcement heretofore wholly left to states and local communities." *Rutkin v. U. S.*, 343 U. S. 130, 141 (1952). One state may require a higher license fee for a permit, another state a fine for continued uninterrupted operation of a motor vehicle bearing the same weight. Under the view of the respondent and the courts below, payment of the former would be deductible, the latter not. Business necessity having widespread legislative acceptance could thus result in tax discrimination by legislative semantics. Despite minor differences, all the

ful, on the one hand, and innocent or non-negligent violators, on the other hand, alike; and that neither hardship nor good faith nor appropriate care constitutes a defense to the state violation.

But the issue in the instant case is not whether there was a violation. It is whether the allowance of the deduction for the payments of fines imposed for the inadvertent violation frustrates the deterring or punishing aspects of the state statutes. Pitched at this level, it matters not, as the Court of Appeals erroneously believed, that the weight laws make no express distinction between innocent and wilful violators (R. 140-141).

If the enforcement provisions of the respective statutes could effectively be applied, a wilful violator must, to the extent there is a purpose to punish or deter, be placed in a different category from the good faith, non-negligent, innocent violator. It may well be that in the scheme of enforcement by local police authorities before justices of the peace or minor judiciary, it would embroil effective enforcement in a morass of litigation to determine ad hoc in each case whether or not the operator of the motor vehicle or the company owning it, knew or should have known that it was overweight at the time it started in transit. For this reason, justification can be found in the imposition of the fine on the innocent and wilful violator alike. But this in no way means that the innocent violator should be doubly punished, and must be treated the same as the wilful violator for every and all collateral purpose. He has already incurred the expense of the fine through no fault of his own, and it serves no purpose to cause him to lose more revenue by refusing the deduction under the income tax laws. There are "penalties and penalties," and there is no reason why the tax laws cannot recognize the unfortunate position in which the innocent and inadvertent violator found himself without defeating in any way the real purposes of the state statutes.

states know how and when to take care of and prevent real threats to the use and safety of the highways. This Court has not been persuaded "that the conventional forms of punishment are inadequate to protect states from overweighted or improperly loaded motor vehicles," (*Castle v. Hayes Freight Lines*, 348 U. S. 64 (1955)) to justify use of the revenue act "as an arm of the law to enforce State criminal statutes by augmenting punishment which the State inflicts." *Burroughs Building Material Co.*, 18 B. T. A. 101, 105 (1929).

Wrongdoers should be punished directly for their sins, and the way is for the appropriate state enforcement officials to do the job, putting the burden of punishment where it belongs and not on the tax system. Aside from the constitutional problems which would come to the fore if Congress undertook to use the federal power to tax income to supplement the police power of the state over criminal law enforcement, by expressly disallowing as deductions ordinary and necessary expenses in violation of state statutes or incidental thereto (see *U. S. v. Constantine*, 296 U. S. 287 (1935); *U. S. v. Kahriger*, 345 U. S. 22 (1953) indicating that a federal tax which is actually a penalty for violation of state law infringes on the Tenth Amendment), the public policy test of the courts below places socially harmless individual violations of unpopular or anachronistic legislation on a par with organized criminal activity. The Seventh Circuit noted in *Commissioner v. Doyle*, 231 F. 2d 635, 638, that one state, such as Pennsylvania actually does today, may prohibit the business of selling automobiles on Sunday or the sale of intoxicating liquor at retail, while another may not. To the extent that ordinary and necessary expenses exist in this similar activity, a holding that they are not deductible in the one state where the business activities were unlawful would mean that such a tax would be levied by the federal government on gross income, whereas a holding that they are deductible in the other states would mean that such a tax would be levied on only

Accordingly, petitioner contends that its innocent and inadvertent violations in the other states were of sufficient frequency in the industry and arose from conditions applicable to the industry as a whole, to constitute the payments of the fines for the violations thereof, ordinary and necessary business expenses, for which the deduction would in no way frustrate any sharply defined policies evidenced by the state weight limitation laws.

CONCLUSION.

The decision of the Court of Appeals should be reversed and the payments by petitioner of the fines pertaining to the state of Pennsylvania, to the state of New Jersey and to the other states should, in all three instances, be deductible as ordinary and necessary business expenses.

Respectfully submitted,

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et income. Certainly the clear language of Section (a)(1)A does not suggest that the Congress contemplated intended such an inequitable consequence to be reached hen payments are incidental to an infraction or violation state statutes having no purpose to suppress crime, but erely the objective of prohibiting acts contrary to local otions of public policy. Unless checked, it can end with tax reaching the gross income of transactions in which ell-meaning taxpayers fail after every possible effort to omply with anachronistic statutes, such as the Pennsylania weight law in the taxable year 1951, designed to express a public policy alien to the complicated ways of the odern business world.

Accordingly, the amounts paid by the petitioner for the ate fines imposed on the overweight violations are deductle as ordinary and necessary business expenses.

I. Tax Deductions for the Payments in Connection with the Fines Would Not Frustrate Any Sharply Defined State Policies.

Even if certain expenditures otherwise ordinary and ecessary under Section 23(a)(1)A are not deductible if hey are penalties, the allowance of which would frustrate a harply defined national or state policy, it is petitioner's lternative contention that the payments which were made n connection with the three types of fines presented here re still deductible.

It should be noted that two separate questions thus merge under this alternative contention. One is whether he fine is, in fact, a penalty. If this is answered in the ffirmative, the second is whether its deduction for tax puroses would frustrate any sharply defined policy of the state tatute. This, in turn, depends upon the nature of the ffense and the place of the sanction in the scheme of enorcement of the underlying act. As the court in *Jerry Rossman Corp. v. Commissioner*, 175 F. 2d 711, 713 (CA2,

1949), stated: "whether the claimed deduction be of legal expenses or of fines or forfeitures, its allowance depends upon the place of sanctions in the scheme of enforcement of the underlying act. We think that . . . [this] . . . is the right reading; in short that there are 'penalties' and 'penalties' and some are deductible and some are not".

There is no dispute that petitioner's overweight vehicles were subject to a fine imposed under a penal statute, taking the term "penal" in its broadest sense. But the tax sanction of non deductibility, when predicated upon "frustration" of "clearly defined state policies evidenced by some governmental declaration of them", does not automatically follow merely because something called a "fine" was properly imposed by state law. The non deductibility can still only be justified, first by identifying it, not with some state whim, but with a sharply defined, i. e., important and rational state policy that warrants the type of social condemnation that is or ought to be implicit in the concept of crime. Then the income tax deduction must clearly interfere with enforcement provisions of this type of state statute which are designed to punish past and deter future violations.

Hence, even under this "frustration" approach, federal tax deductions are not to be subject to the uncontrolled caprice of state legislation, as the Court of Appeals seemed to indicate when it said "Once it is concluded that the regulation is within the sphere of proper legislative action the courts [in a tax controversy] will not gainsay the legislature on just where the arbitrary line between allowable and proscribed weights should be drawn. Nor is it appropriate at this juncture to review state enforcement policies. Such must be the rule if there is to be any semblance of order on this and similar questions" (R. 140a). This is not a "frustration of public policy" analysis. Rather, it is a mistaken concept that once the fine is imposed by legislation which constitutionally falls within

APPENDIX

Vehicle Code of Pennsylvania
Act of May 1, 1929, P. L. 905 as Amended
(in effect in 1951)

719. *Special hauling permits* (75 Pa. Purdon Stat. § 308)

The fee for a special hauling permit shall be five ($5.) dollars plus two ($0.02) cents for each ton of two thousand (2,000) pounds, or fraction thereof, of gross weight of vehicle, or combination of vehicles or vehicle, and load, or combination of vehicles and their load or loads, in excess of the legal gross carrying capacity for which such vehicles or combination of vehicles have been properly registered, for each mile, or fraction thereof, of length of haul, payable to the authorities issuing such permit. The fee for cancelling an unused special hauling permit shall be one ($1.00) dollar, payable to and upon the approval of the authorities issuing the permit.

903. *Weight of Vehicles and Loads* (75 Pa. Purdon Stat. § 453)

* * *

(g) No truck tractor and semi-trailer combined, except fire department equipment, shall be operated upon any highway with a gross weight in excess of forty-five thousand (45,000) pounds, or in excess of twenty thousand (20,000) pounds on any axle, or in excess of eight hundred (800) pounds on any one wheel for each nominal inch of width of tire on such wheel; axle or axles of semi-trailer shall not be less than ninety-six (96) inches from the axle of the truck tractor.

the police power of a state, the fine can never be deducted, regardless of the nature of the underlying offense and whether or not the deduction frustrates any sharply defined policy of the state statute. This Court's opinion in *Heininger* plainly shows the error of this.

a. *Pennsylvania*

The role of the fine in the Pennsylvania statutory scheme of enactment and enforcement was not a penalty imposed on bulk liquid motor carriers for weight violations condemned in any real sense. As was pointed out in *Jerry Rossman Corp. v. Commissioner*, 175 F. 2d 711 (C. A. 2, 1949), a penalty (p. 172):

> Taken in its broadest sense . . . has a punitive, as opposed to a remedial meaning; it covers fines and other exactions which are not restitution for a wrong and are only justified, either as a deterrent, or in order to satisfy an atavistic craving for retaliation.

The fine imposed by Pennsylvania for operating the overweight vehicles was neither punishment for past nor a deterrent to future violations. The fine was imposed upon the individual driving the overloaded vehicle, and not on the owner (75 Pa. Purdon Stat. § 453; 14a-16a, 128a). In fact the owner of the vehicle cannot appeal the conviction of the employee-driver. Only the driver can so appeal. *Hadock v. Lattava Bros., Inc.*, 85 Pa. D. & C. 515 (1953).

But the employee-drivers of the motor vehicle, who alone were subject to the fines, were not in any way factually responsible for the weight of the load. This was the decision deliberately made by the petitioner and the other carriers in the industry. Hence, for the Pennsylvania Legislature consciously to impose the fine on the driver and not, as do the weight laws of the other states, on the company actually responsible for the violation indicates a legislative purpose neither to punish past nor to deter future similar activity on the part of the carriers.

Penalty.—Any person operating any vehicle or combination of vehicles upon any highway with a gross weight or with weight on any one axle or wheel exceeding by more than five (5) percentum the maximum weight allowed in that particular case and not exceeding by more than ten (10) per centum the maximum weight allowed, shall in each case, upon summary conviction before a magistrate, be sentenced to pay a fine of twenty five ($25) dollars and costs of prosecution, and in default of the payment thereof, shall undergo imprisonment for not more than five (5) days, and any person operating any vehicle or combination of vehicles on any highway with a gross weight or with weight on any one axle or wheel exceeding by more than ten (10) per centum the maximum weight allowed in that particular case, shall in each case, upon summary conviction before a magistrate, be sentenced to pay a fine of fifty ($50) dollars and costs of prosecution, and in default of the payment thereof, shall undergo imprisonment for not more than ten (10) days.

* * *

904. *Officers may weigh vehicles and require removal of excess load* (75 Pa. Purdon Stat. § 454).

Any peace officer who shall be in uniform, and shall exhibit his badge or other sign of authority, having reason to believe that the weight of a vehicle or combination of vehicles and load is unlawful, is authorized to weigh the same, either by means of portable or stationary scales, or may require that such vehicle or combination of vehicles be driven to the nearest stationary scales in the event such scales are within a distance of two (2) miles. The peace officer may then require the operator to unload immediately such portion of the load as may be necessary to decrease the gross weight of such vehicle or combination of vehicles to the maximum gross weight specified in this act, except

In this connection, it should be noted that imprisonment of the driver is provided for only upon default in payment of the fine (75 Pa. Purdon Stat. § 453). The sentence of imprisonment is authorized, not as an immediate sanction, but rather to coerce the payment of the fine. In the history of the enforcement of the weight laws by the authorities charged therewith in Pennsylvania, no imprisonment, suspension of driving privileges or other sanctions were imposed on or exacted from the employee-drivers or the bulk liquid carriers, other than the fine (128a-129a). This indicates both an enactment and enforcement policy not to prevent continued operation of the overloaded equipment, a policy inconsistent with the concept of punishment for bad behavior.

Furthermore, although statutory provision was made for discretionary removal of the excess load (75 Pa. Purdon Stat. § 454), there also has been in the history of the enforcement of the statute, no instance known to the industry where the excess weight was required to be removed before the vehicle could continue on its original transit (44a-45a, 82a, 129a). This likewise demonstrates a studied enforcement policy, expressly delegated by the statute, to allow uninterrupted operation of the overloaded equipment upon payment of the fine only. Again, a concept inconsistent with strict penalty and punishment.

Moreover, the fine itself is imposed in one of two fixed amounts, and is not graduated above the maximum sum of \$50.00 on the number of pounds of excess weight, or on the number of violations, as is true with real penalty provisions of the weight laws of other states and with the penalty provision of the new Pennsylvania weight law enacted in 1955 (75 Pa. Purdon Stat. § 453 (pocket part)).

Finally, the statutory disposition of the fines legislatively indicates that they were imposed as a remedial or compensatory rather than a punitive measure, to cover restitution for a supposed wrong, a concept inconsistent with

as herein provided for special permits: And further provided, That no arrests shall be made, or information brought in cases where the maximum gross weights provided in this act are not exceeded by more than five per centum thereof.

Penalty. Any person refusing to unload excess weight when so ordered or violating any of the other provisions of this section, shall, upon summary conviction before a magistrate, be sentenced to pay a fine of fifty ($50) dollars and costs of prosecution, and, in default of the payment thereof, shall undergo imprisonment for not more than five (5) days.

* * * * *

905. *Permits for excessive size and weights.* (75 Pa. Purdon Stat. § 455)

(a) The Secretary of Highways of this Commonwealth, and local authorities in their respective jurisdictions, may, in their discretion, upon application in writing accompanied by the fee provided in this act, and good cause being shown therefor, issue a special permit, in writing, authorizing the applicant to operate or move either a vehicle or combination of vehicles, or a vehicle and load, or a combination of vehicles and their load or loads, of a size or weight exceeding the maximum specified in this act upon any highway under the jurisdiction of and for the maintenance of which the authorities granting the permit are responsible. When a permit has been issued by the Secretary of Highways, no other authorities shall require any further or additional permit for any portion of the route specified therein. Every such permit shall be issued for a single trip, and shall designate the route to be traversed, subject to such rules, regulations, restrictions, or conditions, as shall be deemed necessary by the authority granting such permit: Provided, That, upon request included in the application, a combination permit may be issued for a single continuous round trip, whether or not a load or loads may be transported for the entire trip, but no sub-

that of penalty. *Jerry Rossman Corp. v. Commissioner*, 175 F. 2d 711 (CA-2, 1949). Under the supposition that an overweight vehicle may work damage to the roads and highways, the Pennsylvania statute expressly required that the fines for operating overloaded vehicles within local municipalities be paid to and used by such municipality for the construction, repair and maintenance of its highways (132a, 75 Pa. Purdon Stat. § 737). See *A. L. I., Federal Income Tax Statute*, February 1954 Draft, Volume I, Section x 165(i)(2) which proposes that fines or penalties imposed primarily for compensatory damage are deductible.

Hence it is submitted that the Tax Court was in error in lifting out of context the characterization of the weight law as "penal". *Com. v. Burall*, 146 Pa. Super. 525, 529 (1942). Whatever circumstances might be present in some other state, where the penalty provisions could be said to have been enacted and applied to enforce obedience to prescribed weight limitations and to punish violators, no such purposes were present for the bulk liquid motor carrier industry in Pennsylvania in 1951.

The Court below observed in *McDonald v. Penna. Railroad Co.*, 210 F. 2d 524, 528 (1954) that there are two obvious reasons for the Pennsylvania weight limitation law. The first is that an overweight vehicle may work serious damage to a road and the second is that an overweight vehicle may be an obstacle to the free movement of traffic, thereby creating a traffic hazard. If the fines paid by petitioner were not to punish nor deter activities creating these results, the deduction of their payment for income tax purposes would not frustrate any sharply defined policies of the Pennsylvania weight law. See *The Tax Fortnighter*, Vol. 5, No. 12, which, in criticising the Tax Court opinion below, suggests (p. 685) that Pennsylvania employed a "fining" procedure in lieu of tolls as a matter of understandable expedience and cloaked a "remedial" statute in penal form.

stantial increase in the size or weight of vehicle or combination of vehicles or of load shall be made between intermediate points without supplemental permit. The Secretary of Highways may, in his discretion, issue a single permit for any fixed number of movements across the highway of vehicles or combinations thereof exceeding the maximum size or weight specified in this act at specified locations. Whenever any such permit shall have been issued for crossing the highway, it shall be unlawful to move said vehicles along the highway. The movement of any vehicle or load requiring a permit shall impose the obligation on the permittee to restore or replace any section of highway or bridge damaged as a result of such movement, whether or not such damage may be attributable to negligence on the part of the permittee. Every such permit shall be carried in the vehicle to which it refers, and shall be open to inspection by any peace officer or employe of the Department of Highways of this Commonwealth or to any person having collision with or suffering injury from such vehicle.

* * *

Penalty.—Any person operating or moving a vehicle or load of a size or weight exceeding the maximum specified in this act, without first having obtained a permit or permits so to do, and any person altering or forging a special permit for excessive size and weight, or presenting or exhibiting an altered or forged special permit for excessive size and weight, shall, upon summary conviction before a magistrate, be sentenced to pay a fine of fifty ($50) dollars and costs of prosecution, and, in default of the payment thereof, shall undergo imprisonment for not more than ten (10) days.

* * *

1207. *Disposition of fines and forfeitures* (75 Pa. Purdon Stat. § 737)

(a) All fines and penalties collected under the provisions of this act for violations of the same, and all bail

The enforcement of the maximum weight provisions by the officers charged with this responsibility, just as was true with the Price Administrator in *Jerry Rossman Corp. v. Commissioner*, points up the fact that there was no important policy underlying the Pennsylvania weight law which would be frustrated by the allowance of the income tax deduction for the amounts of the fines. Although it is unquestioned that, unlike *Rossman*, petitioner and the industry consciously knew that their vehicles were overweight in Pennsylvania when filled to capacity with anything but gasoline, nevertheless, as has already been shown, both the Legislature itself in the provisions of the statute and the police officers in enforcing it, recognized the discriminatory position which the unduly restrictive Pennsylvania weight law placed upon the bulk liquid motor carrier industry. In fact, for many years prior to the taxable year, the bulk liquid carrier vehicles were not stopped, weighed and fined, (129a) a recognition that the Pennsylvania law was antiquated in relation to the tremendous improvement both in the maneuverability of the larger trucks and in the highways themselves, and particularly in relation to the larger weight limits permitted in the surrounding states.

Hence, when enforcement was actively undertaken in the latter part of 1950 without any new legislation, the authorities themselves, as had the Legislature in the enactment of the law, indicated their content with the payment of the fine for the underlying purpose not to punish or deter, but to reimburse and compensate for alleged road damage. The fully loaded standard equipment was operating safely in the other states, and in the properly delegated opinion of the Pennsylvania enforcement authorities, could similarly continue to so operate in Pennsylvania without creating an obstacle to the free movement of traffic. Otherwise, the enforcement authorities would have required what they did not, namely the removal of the excess load.

forfeited, shall be paid to the department, and transmitted to the State Treasury, and credited to the "General Fund," except those collected for violations of the provisions of sections nine hundred and three (903), nine hundred and five (905), one thousand and two (1002), one thousand and eleven (1011), one thousand and fifteen (1015), one thousand and eighteen (1018), one thousand and twenty (1020); one thousand and twenty-six (1026); one thousand and twenty-eight (1028) of this act, committed within cities, boroughs, incorporated towns and townships, which fines and penalties and all bail forfeited shall be paid to the treasurer of the city, borough, incorporated town, or township wherein the violation occurred, to be used by such city, borough, incorporated town, or township, for the construction, repair, and maintenance of the highways thereof: Provided, That all fines and penalties collected and all bail forfeited for violations of the provisions of section one thousand and sixteen (1016), committed within cities, boroughs, incorporated towns, and townships, shall be paid to the treasury of the city, borough, incorporated town, or township wherein the violation occurred, to be used by such city, borough, incorporated town, or township, for the construction, repair and maintenance of the highways thereof: And provided further, That all fines and penalties collected and all bail forfeited for violations of the provisions of subsection (f) of section six hundred twenty (620), shall be paid to the treasury of the county wherein the violation occurred, to be used by such county for the payment of physicians' fees for the examination of persons accused of violating the provisions of the said section. Any balance remaining in the treasury of the county at the expiration of the calendar year, and not payable for physicians' services rendered, shall be used for county highway purposes.

* * *

Furthermore, just as the Court in *Rossman* found that a Congressional amendment to the Emergency Price Control Act subsequent to the taxable year revealed a legislative recognition that repayment for innocent violations did not frustrate any sharply defined policies of that Act in a year prior to the amendment, so also, in the instant case, the Pennsylvania legislature in 1955 amended its weight laws to conform to the weights generally prevailing in the neighboring states, and to remove the discriminatory position which confronted the bulk liquid motor carrier industry in the taxable year (75 Pa. Purdon Stat. § 453 (pocket part)). This likewise shows the Pennsylvania legislature's recognition that the industry equipment which for many years prior to 1955 was bearing an approximate weight of 60,000 lbs. in the adjoining states without causing damage to the roads or an obstacle to traffic, could also operate under the same conditions in the state of Pennsylvania.

Hence, legislative removal of the earlier restrictive weight provision further indicates the place of the fine in the earlier scheme of enforcement—to allow continued operation of equipment which was really not harmful, upon payment of a fee in the form of a fine. In addition, the adoption of provisions in the new 1955 Pennsylvania legislation graduating the amount of the fine to the number of pounds overweight, and requiring mandatory and not discretionary removal of the excessive portion of the load by the enforcement authorities, indicates a new deterrent policy, absent from the earlier statute in force in 1951 (75 Pa. Purdon Stat. §§ 453, 454 (pocket part)).

Another factor which throws light upon the role of the fine in the scheme of enforcement of the weight limitation law, and whether its recognition as a legitimate deductible business expense would offend or frustrate Pennsylvania policies, is the manner in which the fine was treated by other state regulatory bodies. The Penn-

Act No. 70, Approved and Effective June 30, 1955, Amending the Vehicle Code of Pennsylvania.

* * *

903. *Weight of Vehicles and Loads* (75 Pa. Purdon Stat. § 453 (pocket part)

* * *

Whenever two vehicles are used or operated as a combination on any highway, the gross weight of the combination shall not exceed the sum of the maximum gross weights allowed for the respective vehicles and, in addition, the gross weight of the combination shall not exceed the gross weight specified as follows:

Combination.	Maximum Gross Weight in Pounds.
Truck tractor and single-axle semi-trailer	50000
Truck tractor and two-axle semi-trailer	60000
Commercial motor vehicle and trailer	62000

* * *

Penalty.—Any person operating any vehicle or combination of vehicles, upon any highway, with a gross weight or with weight on any axle or wheel exceeding by more than three (3) per centum the maximum weight allowed in that particular case, shall, upon summary conviction before a magistrate, be sentenced to pay the costs of prosecution and a fine for each and every pound of excess above the maximum weight allowed according to the following schedule:

If the excess is.	The fine shall be.
Not over 3000 pounds	$60.00
Over 3000 pounds, but not over 3500 pounds	120.00
Over 3500 pounds, but not over 4000 pounds	140.00
Over 4000 pounds, but not over 4500 pounds	240.00
Over 4500 pounds, but not over 5000 pounds	270.00
Over 5000 pounds, but not over 5500 pounds	400.00
Over 5500 pounds, but not over 6000 pounds	440.00
Over 6000 pounds, but not over 6500 pounds	600.00

sylvania Public Utility Commission, in regulating the activities of motor carriers subject to its jurisdiction, required that all accounting books, records and reports be prepared in accordance with Uniform System of Accounts, as interpreted by the Interstate Commerce Commission. Under this Uniform System, fines for operating overweight equipment in violation of state limitation laws were, in the taxable year and prior thereto, treated as an operating expense and recognized as a legitimate expense for rate making purposes (129a-130a).

Petitioner recognizes that accounting requirements of a regulatory agency are not controlling for tax purposes. Thus, in *Old Colony Railroad Co. v. Commissioner*, 284 U. S. 552, 562 (1932), this Court said that rules of accounting enforced upon a carrier by the ICC "are not binding upon the Commissioner, nor may he resort to the rules of that body, made for other purposes, for the determination of tax liability under the revenue acts".

However, it is equally true that although such rules of accounting are not binding, they may be considered as evidence of what is good, acceptable procedures resulting in the true reflection of income. In *Great Northern Ry. Co.*, 8 BTA 225 (1927), aff'd, 40 F. 2d 372 (CA 8, 1930) certiorari denied, 282 U. S. 855, the Board of Tax Appeals, in denying the fines paid by a railroad for violation of certain federal regulatory statutes in connection with the operation of the road were deductible as ordinary and necessary business expenses, noted at page 264 that the ICC did not classify such fines as operating expenses. Unlike the treatment accorded petitioner's overweight fines by the ICC, placing them in an operating expense account No. 4280 subtitled "Fines for traffic violations" (R. 129a-130a), the Great Northern Ry. Co. fines were required to be entered in a non-operating expense account not properly chargeable to income, covering fines for violations of the Act to regulate Commerce and other federal laws. The

For each additional 500 pounds, or part thereof, over 6500 pounds, $600.00 plus $50.00 for each additional 500 pounds, or part thereof: Provided That, in any case, in which there shall be concurrent violations of more than one of the clauses of this section prescribing maximum weights the penalty imposed shall be for violation of that clause which produces the greatest fine, but no penalty shall be imposed for violation of any other such clause.

* * *

In default of payment of any fine and costs of prosecution imposed, pursuant to the foregoing provisions of this penalty clause, the magistrate shall impound the vehicle, or combination of vehicles, and order the arresting officer, or other peace officer, to seize them. The magistrate shall, forthwith, notify the sheriff of the county wherein the violation occurred, who shall store the impounded vehicle, or combination of vehicles. The sheriff's costs, storage costs, and all other costs incident to impounding, shall be deemed additional costs of prosecution. The sheriff shall give immediate notice by telegram and registered mail, return receipt requested, of the impoundment and location of the vehicle, or combination of vehicles, to the owner of said vehicle, or combination of vehicles, and the owner of the load if said owners' names and addresses are known or can be ascertained by the sheriff.

The title to the load shall remain in the owner thereof and he shall be entitled to repossess it at any time upon presentation of proof of such ownership to the sheriff. If the load shall spoil during possession by the Commonwealth, the loss shall be upon the owner thereof, subject to any right of recovery of damages at common law that he may have against the owner of the vehicle or combination of vehicles and the cost of disposition thereof shall be deemed an additional cost of prosecution. In case any vehicle or combination of vehicles impounded or the load thereon as aforesaid, shall remain unredeemed, in the case of the vehicle or com-

Board of Tax Appeals, therefore, found this persuasive evidence that the fines paid by the railroad were not deductible as ordinary and necessary business expenses. Similarly, the fact that neither the Pennsylvania P. U. C. nor the I. C. C. for its own purposes, outlawed the overweight fines as a legitimate operating expense of motor carriers, indicates in no small part that the allowance of the payments for the fines as deductions for income tax purposes would not be offensive to the real policies and purposes of the Pennsylvania weight limitation law.

Furthermore, it is also highly significant that from 1942 to the latter part of 1950, respondent, by letter ruling, allowed the fines incurred for such overweight violations to be deducted as ordinary and necessary business expenses (App. 9a-12a). No sharply defined state policies were then thought to be frustrated. Petitioner was formed during this period. It acquired substantially all its equipment during this period. Nothing happened, at least in Pennsylvania, after respondent reconsidered his earlier ruling and disallowed the deduction for the period beginning December 1, 1950, to justify holding that for the future, a frustration of the Pennsylvania weight law would exist where previously it did not (App. 12a).

It should be noted that respondent first took the position that, although the payments for overweight violations were designated as fines in the respective state statutes, they more nearly resembled tolls, allowing the carriers the right to proceed upon the highways of the states without interference, than penalties imposed as punishment for violations of law. Respondent then also observed that the fines in the majority of cases were for revenue and no attempt was made by the states to have the excess load removed.

It is petitioner's contention that, insofar as Pennsylvania is concerned, respondent was correct in his earlier policy of allowing the payments of the fines as busi-

-nation of vehicle and unclaimed, in the case of a load, for a period of sixty (60) days after notice of impoundment is given as aforesaid, the same shall be deemed to be abandoned and shall be disposed of by the sheriff upon order of the magistrate, in accordance with the procedures outlined in section four of the act, approved the third day of July, one thousand nine hundred forty-one (Pamphlet Laws 263), with the exception that the reference to a court therein contained for the purposes of this act, shall be construed to mean magistrate: And provided further, That the proceeds of such sale after the payment of encumbrances shall be applied to the payment of fine and costs and the balance thereof shall be remitted to the owner.

For the enforcement of this section all peace officers shall have the power to arrest on view for violation of any of the provisions of this section.

* * *

§904. (75 Pa. Purdon Stat. §454 (pocket part)) *Officers May Weigh Vehicles and Require Removal of Excess Load.*—Any peace officer who shall be in uniform, and shall exhibit his badge or other sign of authority, having reason to believe that the gross weight of a vehicle or combination of vehicles or the weight upon any axle or pair of axles thereof is unlawful, is authorized to weigh the same, either by means of portable or stationary scales, or may require that such vehicle or combination of vehicles be driven to the nearest stationary scales in the event such scales are within a distance of two (2) miles. If the gross weight or weight upon any axle shall exceed the maximum weight allowed therefor the peace officer may and if such excess is more than three (3) per centum of such maximum weight allowed he shall require the operator to reduce the load so as to bring the gross weight or weight upon an axle to not more than the maximum weight allowed except as herein provided for special permits.

Penalty.—Any operator who shall fail, neglect or refuse to comply with the requirements of a peace officer given pursuant to the provisions of this section, shall, upon summary conviction before a magistrate, be sentenced to pay a fine of one hundred ($100) dollars and costs of prosecution, and, in default of the payment thereof, shall undergo imprisonment for not more than thirty (30) days. In addition to the foregoing penalty the Secretary may suspend the operating privilege of the operator for a period of thirty (30) days.

Text of a Letter Dated September 10, 1942, and Signed by Guy T. Helvering, Commissioner (Symbols, IT:P:2—WTL): (1950 CCH—Stand. Fed. Tax Rep. Vol. 5, ¶ 6134).

Reference is made to your letter of July 29, 1942, requesting advice with respect to the deductibility, for Federal income tax purposes, of "fines" incurred and paid to a State by motor carriers for violation of laws relating to maximum weights and lengths of trucks, consisting of a tractor and semi-trailer operating upon the highways of such State.

The pertinent facts are that the various States have their own laws as to maximum weights and lengths which vary considerably. Under the laws of the State of New York a tractor semi-trailer is allowed to carry 50,800 pounds while under the laws of the State of Tennessee the same equipment is allowed to carry only 30,000 pounds. The following example is set forth in your letter:

> Let us consider a hypothetical case where an operator has two units, each consisting of a tractor and semi-trailer; each unit having an unladen weight of 15,000 pounds. Should the carrier receive cargo weighing 60,000 pounds in State A where the weight limits allow 50,800 pounds; he could place on the one unit 35,800 pounds of cargo, which with the empty vehicle would

make a gross weight of 50,800. The other unit could be loaded with 24,200 pounds, which with the empty vehicle would make a gross weight of 32,200 pounds, and be under the weight limits for State A. Should this cargo have to travel through State B with a weight limitation of 45,000 pounds through State C, with a weight limitation of 40,000 pounds to State D, with a weight limitation of 30,000 pounds, there would be two courses open to the carrier. One would be to secure permits for the particular unit which might be overweight in accordance with the State law, if such State issued permits. The other would be to load his cargo and take a chance on going through the States and paying a "fine" if caught, as the "fines" in most cases would be about the same as the cost for a permit. In our hypothetical case the heavier of the two units would be overweight in all States except the originating State and lighter of the two could pass through all States except E, the destination point.

You state that the matter of securing permits often forces the operator to take the chance on paying "fines", as it would probably require at least three or four days for a Maryland operator to secure permits in the States referred to above, and this delay might result in several contingencies, such as spoiling of perishable goods or loss of the cargo because of the urgency and need for speed. Should the operator decide on delaying the cargo and abide by all the laws, he could list the cost of permits as ordinary business expense and deduct it in his income tax return, but should he, as a matter of business, to prevent loss and satisfy the shipper and consignee, take his chances with "fines", he would not be permitted to deduct them in his income tax return. The "fines" in the majority of cases are for revenue and no attempt is made to have the excess load removed, which would place the "fines" in the same category as the amount paid for permits.

Amounts paid as penalties for violation of State statutes have been held to be non-deductible for Federal income tax purposes either on the ground that such expenditures were avoidable and therefore are not a necessary incident to the operation of a business or because, on grounds of public policy they ought not to receive any sanction. (See *Burroughs Building Material Company v. Commissioner*, 18 B. T. A. 104, affirmed 47 Fed. (2d) 178, Ct. D. 297, C. B. X-1, 337 (1931) and *Great Northern Railway Company v. Commissioner*, 40 Fed. (2d) 372; see also G. C. M. 11358, C. B. XII-1, 29 (1933) in which it is held that penalty payments in connection with income taxes, whether on account of negligence, delinquency, or fraud are not deductible from gross income.) However, as indicated in the *Burroughs Building Material Company* decision, *supra*, expenditures which are in themselves immoral, such as for bribery of public officials to secure protection of an unlawful business, would not have to be allowed in order consistently to justify a deduction of "fines" paid for violations of law involving no moral turpitude and practically inevitable. The court stated in that decision, in referring to the *Great Northern Railway Company* case, *supra*, that "fines" for violations of regulations, which are inevitable in any large railroad system may, for that reason, reasonably be allowed as "ordinary and necessary" expenses of the business.

Although the amounts paid by the motor carriers are designated as "fines" in the statutes and regulations of the several States, they more nearly resemble a toll allowing the carriers the right to proceed upon the highways of such States without interference than as penalties imposed as a punishment for violations of law. The payment of such "fines" are shown by the facts to be a necessary incident to the operation of the business of such carriers.

It is the opinion of this office that the "fines" incurred and paid by the motor carriers under the circumstances stated above constitute "ordinary and necessary expenses

paid or incurred during the taxable year in carrying on any trade or business" within the meaning of section 23(a) of the Internal Revenue Code and are allowable business expense deductions."

Special Ruling Dated November 30, 1950 (1951-1 C. B. p. 15).

Reconsideration has been given to the conclusion heretofore reached by the Bureau that fines paid by truck operators for violations of State laws prescribing maximum weights, loads, and sizes of vehicles are deductible from gross income as ordinary and necessary business expenses under Section 23(a)(1)(A) of the Internal Revenue Code.

That conclusion was based upon the understanding that the fines in question were paid in lieu of fees which would have been payable for permits to operate overloaded or overlength vehicles, and that such permits were generally granted by the State highway authorities. The fines were, therefore, regarded as more in the nature of tolls than penalties.

Upon reconsideration of the question involved it appears that the premise on which the Bureau's conclusion was based was erroneous. It is therefore held that fines paid by truck operators for violations of State laws prescribing maximum weights, loads, and sizes of vehicles are penalties which are not deductible as ordinary and necessary business expenses under section 23(a)(1)(A) of the Internal Revenue Code. (See *Burroughs Building Material Co. v. Commissioner*, 47 Fed. (2d) 178, Ct. D. 297, C. B. X-1, 397 (1931), and G. C. M. 11358, C. B. XII-1, 29 (1933)).

Pursuant to authority contained in section 3791(b) of the Code, the instant ruling will not be applied to fines incurred or paid prior to December 1, 1950.